S. HRG. 108–449

HUD'S PROPOSED RULE ON THE REAL ESTATE SETTLEMENT PROCEDURES ACT

HEARINGS

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

ON

ISSUES RELATING TO THE REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA) AND TO ADDRESS THE PROBLEMS THAT HAVE BEEN IDENTIFIED WITH RESPECT TO HOME MORTGAGE CLOSINGS

MARCH 20 AND APRIL 8, 2003

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE

93–708 PDF WASHINGTON : 2004

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

RICHARD C. SHELBY, Alabama, *Chairman*

ROBERT F. BENNETT, Utah
WAYNE ALLARD, Colorado
MICHAEL B. ENZI, Wyoming
CHUCK HAGEL, Nebraska
RICK SANTORUM, Pennsylvania
JIM BUNNING, Kentucky
MIKE CRAPO, Idaho
JOHN E. SUNUNU, New Hampshire
ELIZABETH DOLE, North Carolina
LINCOLN D. CHAFEE, Rhode Island

PAUL S. SARBANES, Maryland
CHRISTOPHER J. DODD, Connecticut
TIM JOHNSON, South Dakota
JACK REED, Rhode Island
CHARLES E. SCHUMER, New York
EVAN BAYH, Indiana
ZELL MILLER, Georgia
THOMAS R. CARPER, Delaware
DEBBIE STABENOW, Michigan
JON S. CORZINE, New Jersey

KATHLEEN L. CASEY, *Staff Director and Counsel*
STEVEN B. HARRIS, *Democratic Staff Director and Chief Counsel*
SHERRY E. LITTLE, *Legislative Assistant*
MARK CALABRIA, *Senior Professional Staff*
JENNIFER FOGEL-BUBLICK, *Democratic Counsel*
JONATHAN MILLER, *Democratic Professional Staff*
JOSEPH R. KOLINSKI, *Chief Clerk and Computer Systems Administrator*
GEORGE E. WHITTLE, *Editor*

C O N T E N T S

THURSDAY, MARCH 20, 2003

WITNESS

Additional Material Supplied for the Record

TUESDAY, APRIL 8, 2003

WITNESSES

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

ISSUES RELATING TO HUD'S PROPOSED RULE ON THE REAL ESTATE SETTLEMENT PROCEDURES ACT

THURSDAY, MARCH 20, 2003

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 9:35 a.m. in room SD–538 of the Dirksen Senate Office Building, Senator Richard C. Shelby (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The hearing will come to order.

I want to thank Mel Martinez, Secretary of the Department of Housing and Urban Development, for coming here today. We asked the Secretary to appear before the Committee today to discuss the Department's Proposed Rule on the Real Estate Settlement Procedures Act, or RESPA, as it is known in the industry.

I understand that the Secretary has another commitment and won't be able to be with us all day. But I hope you can be here for an extended period of time. However, I know you are going to want to have the opportunity to fully address our questions, since RESPA is one of the Department's top priorities. I want to do what I can to respect your time constraints because we are going to have several hearings on this.

Secretary MARTINEZ. We don't have a problem, Mr. Chairman.

Chairman SHELBY. So, I have asked Members on both sides as they come in to waive their opening statements so that we can get directly to your testimony and the questions.

Mr. Secretary, before you proceed with your opening statement, you should know from the outset that while I and many on this Committee support the goals of your effort, we have significant concerns with the Rule as proposed. RESPA reform has broad, far-reaching implications for the $2 trillion housing industry and the changes proposed would affect all players in the market—from consumers to lenders, to settlement service providers, and many others. I understand the Subcommittee on Housing and Community Opportunity, the full Committee on House Financial Services, and the House Committee on Small Business have all had hearings on this issue. And I was told earlier this morning that there are going to be more hearings over in the House. That, and the 40,000 comments your Department has received on this proposal, should be indicative of the great level of interest and concern that this

Rule has generated. With that, I will let you, Mr. Secretary, proceed with your opening statement and we will go from there.

We welcome you to the Committee.

STATEMENT OF MEL MARTINEZ
SECRETARY
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Secretary MARTINEZ. Mr. Chairman, thank you very much and it is good to be back with you. And while I do have some other issues to address, I am certainly here for as long as it is necessary for me to attempt to answer all of the questions. Although I will say, as it gets tremendously technical, I may need some assistance from some of our folks.

Chairman SHELBY. Okay. We all do that. We all need it.

Secretary MARTINEZ. Yes, sir. But I appreciate the chance to come and let you know what I believe is one of our very important initiatives for the Bush Administration in terms of the reform of the Settlement Procedures Act. We have fuller comments which we will put in the record.

Chairman SHELBY. Your written testimony will be made part of the record in its entirety.

Secretary MARTINEZ. Thank you very much. We are committed to helping more families achieve the dream of homeownership. And as we do that, we believe that the mortgage finance process and the cost of closing remain major impediments to homeownership. Every day, Americans enter into mortgage loans, which are the largest financial obligations most families ever undertake, without the clear and useful information they receive with most any other major purchase. The uncertainty hurts consumers.

Therefore, we are streamlining and improving the mortgage finance process through the reform of the rules governing the Real Estate Settlement Procedures Act. Our intent is to establish better and timelier disclosure for consumers so that they have the opportunity to shop for the best loan, to simplify the mortgage origination process itself, and to eliminate the confusion and uncertainty, and ultimately, to lower the settlement costs for homebuyers. At the same time, the Department is committed to issuing a Final Rule, fully mindful of the impacts on small businesses.

The Proposed Rule addresses the inadequacies of the existing regulatory scheme by fundamentally changing the way in which compensation to mortgage brokers is disclosed to borrowers. That is a very important issue because there have been an incredible number of concerns and even litigation relating to mortgage broker disclosures, significantly improving HUD's Good Faith Estimate, GFE, the settlements' costs and disclosures, and removing the regulatory barriers to allow the industry the option of offering guaranteed packages of settlement services and mortgage loans to borrowers.

Most loans originated by mortgage brokers include a yield spread premium. These help families buy homes when they do not have enough cash for a downpayment and closing costs. A lender pays part of these costs to the broker and, in turn, the lender is compensated by a higher interest rate on the loan.

The current Good Faith Estimate does not explain what yield spread premium is and does not make clear how it helps the homebuyer. Our Proposed Rule included a new proposed Good Faith Estimate form, which is intended to make this clear. We want to make sure that consumers know which loan is going to cost them the least, whether it comes from a broker, a lender, or anyone else. We want to level the playing field. We are working with the Federal Trade Commission on that and we are testing alternative GFE's.

In many of the comments received by the Department, we have heard concerns that packaging would be dominated by the large lenders. The truth, in fact, is that our Proposed Rule would level the playing field between large firms and small firms. This is due to the fact that RESPA currently places a much greater burden on dealings between firms than on any one firm in-house and affiliated operations.

Essentially, there is nothing stopping larger firms from buying the smaller firms today if the transaction were to make sense. For instance, if a large lender wanted to have his own in-house appraisers, this employee-employer relationship would be largely free from RESPA. Whereas, this transaction between a lender and an independent appraiser is currently subject to RESPA.

Put simply, any lender can largely get around RESPA today by bringing all settlement services in-house. The reason you do not see this today is that it is not economical and we do not envision it being any more economical under our new proposal.

The intent of the Proposed Rule is not to change the playing field, but to remove regulatory barriers and allow greater innovation. In our Proposed Rule, we ask 30 questions. We wanted consumers and businesses to give us their comments on these important issues. We have been in active consultation with those in the business and we will continue to look to the comments of interested parties and formulate in the Final Rule.

HUD received nearly 43,000 public comments in response to our Proposed Rule. The 18 weeks since the comment period closed on October 28, 2002, have been spent carefully studying the written comments. These comments came from individuals and businesses who provide settlement services, such as mortgage brokers, lenders, title companies and appraisers, and from consumer advocates. Also there were many detailed letters from trade associations.

Many of the comments have come from small businesses, and I want to take this opportunity in this hearing to emphasize my commitment to ensuring the fullest consideration of the regulatory impacts on small businesses in our RESPA rulemaking.

We regard this Administration's RESPA reform and small business objectives as necessarily complementary. For RESPA reform to work, small businesses must continue to serve a pivotal rule in an efficient and effective settlement process. Small businesses have long been incubators of innovation. We will structure a Final Rule to maintain the important role of small businesses in the real estate industry.

HUD is very committed to creating a homebuying and mortgage-finance process that protects consumers by being grounded in transparency and simplicity. By reforming the rules governing the

purchase and finance of homes, we will create new opportunities for the first-time homebuyers, keep the American Dream of homeownership alive for more families, and inspire greater public confidence in the mortgage-lending process.

And again, Mr. Chairman, I would be happy to try to answer your questions and we are pleased to be here with you today.

Chairman SHELBY. Thank you, Mr. Secretary.

Secretary Martinez, just about every small business organization, including the NFIB and every settlement service provider, has significant objections to your Rule.

The National Association of Realtors and Homebuilders have voiced substantive concerns about the impact of this Rule on the mortgage market especially.

Community bankers think it will give large lenders an unfair competitive advantage. Minority small business-owners worry that they will be closed out of the process and with them, the communities they serve.

The SBA Office of Advocacy says that you did not sufficiently follow the law in formulating this Rule. And the FTC—the Federal Trade Commission—says it is not sure if this Proposed Rule will actually result in greater clarity to the consumer and even might actually harm the consumer.

The consumer groups are tepid and worried about the impact on low-income borrowers. The House Financial Services Committee, the House Subcommittee on Housing, the House Small Business Committee, and now this Committee—we have held hearings on this Proposed Rule. And I am certain there will be more.

Mr. Secretary, this raises very real, very serious concerns about how this will affect the competitive landscape of the mortgage market. How do you explain the unprecedented controversy surrounding your Proposed Rule?

Secretary MARTINEZ. I would say, Mr. Chairman, that if it was easy and uncontroversial, it would have been done a long time ago.

The fact that it does shake up the marketplace does not deprive the merits of the proposal. We have received a large number of comments. The fact is that we have been actively engaged in discussions and hearing from these comments, proposals, and additional input on how this Rule might be made more palatable to many of the interests that you mentioned. The fact is that the mortgage bankers are very supportive of it. They don't believe it is going to have an impact on the mortgage industry or in the availability of mortgage money. Quite the contrary.

Mr. Chairman, this is a Rule that for more than 30 years, has largely gone unreformed and unchanged, at the same time that the mortgage-backing industry, the lending industry, has gone through tremendous changed. We didn't have PC's in offices when this was envisioned. So, I do believe that what we are doing is important. It isn't easy. And it does cause people concern because it changes the way business is done.

I do hope you know that we are trying very, very much to listen to the comments and deal with a lot of the issues that are raised. In fact, I think they effectively have dealt with a lot of the issues that initially surrounded this Rule.

Chairman SHELBY. That is what hearings are about.

Secretary MARTINEZ. Exactly. Exactly. And so, we have not been inflexible. We have not been committed to a course and not understanding that there are impacts from all sides.

We have people like the AARP that are very supportive of what we are trying to do. We believe that this is well-intended and we believe that it can make a big difference in changing how business is done.

Chairman SHELBY. Mr. Secretary, the release for the Proposed Rule claims that one of its benefits would be, and I will quote: "To improve the existing RESPA disclosure scheme by establishing a new required format for the Good Faith Estimate providing greater accuracy and usefulness for borrowers." Do you agree with that characterization?

Secretary MARTINEZ. That it would provide——

Chairman SHELBY. Yes, this is your——

Secretary MARTINEZ. Yes, sir.

Chairman SHELBY. Okay. One of the touted features of the Good Faith Estimate format is the reclassification of lender-paid fees for mortgage brokers. The Rule will reclassify, as I understand it, the lender-paid fees as payments to the borrower. Is that correct?

Secretary MARTINEZ. That's correct.

Chairman SHELBY. Will release fees that other mortgage originators receive when they sell a loan in the secondary market also be disclosed as part of the Good Faith Estimates under your original proposal?

Secretary MARTINEZ. We have been trying to work with the mortgage broker industry to try to make sure that the disclosure of——

Chairman SHELBY. The answer is no.

Secretary MARTINEZ. The answer is no. But there is a good reason why the answer is no.

If you want me to hold there, I will.

Chairman SHELBY. No, I want you to explain because this is causing a lot of trouble.

Secretary MARTINEZ. Right.

Chairman SHELBY. I think everything ought to be disclosed.

Secretary MARTINEZ. Exactly. And what we had in the past is that mortgage fees were not disclosed—I mean, broker fees were not disclosed. What we had also was tremendous abuse of the yield spread premium.

Chairman SHELBY. Sure.

Secretary MARTINEZ. Which it does not belong to the broker, but it is really designed to help the borrower that can't afford the downpayment and all the costs.

Chairman SHELBY. Absolutely.

Secretary MARTINEZ. To have up-front money. That doesn't belong to the mortgage broker. It belongs to the borrower. So it ought to be disclosed as such so that they understand it and they know it is their money that they are getting to help them in the closing process.

Chairman SHELBY. Why not disclose everything?

Secretary MARTINEZ. Because whether or not——

Chairman SHELBY. Wait a minute. What is wrong with disclosing and putting everything on top of the table where the consumers know what the costs are, who gets what, and for what?

Secretary MARTINEZ. Mr. Chairman, the secondary mortgage market is part of the business. When a banker decides days after closing to sell the mortgage loan, it is not something that is known on the day of the closing.

We can't ask a banker to disclose on the day of the closing what he may or may not do in a month, 2 months, 6 months later, and what that transaction may cost the banker and the secondary marketer. In other words, that fee that the banker may get is not a definitive fee. It is not part of the closing and it is not paid by the consumer. So, therefore, Mr. Chairman, we cannot do that.

What we can do is work with the broker industry, as we have been doing, to try to ameliorate what seemed to them initially to be a very unfair description and designation of the fee in a way that would be a competitive disadvantage to them.

We are working diligently with them to try to accommodate those concerns and find a way that we can disclose the fee, let the consumer know what is happening, but not disadvantage the mortgage broker industry.

Chairman SHELBY. But disclosure, I believe is sound policy.

Secretary MARTINEZ. Absolutely.

Chairman SHELBY. When things are hidden from the consumer or from everybody, you begin to question that. That is just common sense.

Secretary MARTINEZ. Totally.

Chairman SHELBY. Okay.

Secretary MARTINEZ. The problem we face is that we cannot disclose the fee that is not part of the closing transaction. The Settlement Procedures Act deals with the settlement. The fee you are speaking of is not a fee at closing.

Chairman SHELBY. Senator Reed.

COMMENTS OF SENATOR JACK REED

Senator REED. Thank you very much, Mr. Chairman.

First, let me commend the Secretary. I know that this has been an arduous task. The Rule is not perfect, far from perfect, but at least we are talking about a rule today. So thank you for your leadership on that.

Last year, at our hearing, Mr. Secretary, there was some debate about whether yield spread premiums are adequately disclosed under the current system. Currently, these premiums are disclosed as payments made by the lenders to the broker outside of closing.

It is my understanding that nowhere in the current HUD–1 closing form or the Good Faith Estimate is it required that the broker inform the borrower that the broker is receiving a payment for the lender specifically in exchange for the borrower getting a higher interest rate. Nor is it required to disclose that the borrower is paying for that yield spread premium by accepting a higher interest rate. Is that correct?

Secretary MARTINEZ. That is correct, sir.

Senator REED. The Rule that you are proposing would rectify this. Can you explain that?

Secretary MARTINEZ. That absolutely is correct.

Senator REED. The Guaranteed Mortgage Package is one of the more innovative approaches in this Rule. I presume that in order

to make it work, that the closing costs and the interest rate must be fixed. Is that your presumption?

Secretary MARTINEZ. That would be correct, yes, sir. The borrower would have a fixed rate.

Senator REED. Also the closing costs.

Secretary MARTINEZ. And the closing costs. So, they would go into the transaction knowing what it is going to cost them, period, amen. They know the interest rate and they know the closing costs.

Senator REED. There has been some concern that large companies will have an advantage in offering these GMP's. Specifically, they will be able to—in fact, the allegation—push the smaller settlement companies out of the business. Do you have any concern about that, Mr. Secretary?

Secretary MARTINEZ. It is a concern, but it is also not something that we believe would occur because the settlement companies are local. They are closer to the consumer. There are 12,000 lenders in the mortgage business today. In fact, today, a large lender could, just by hiring within their firm, a settlement service provider, a real estate appraiser, a land title company, conduct a package fee, and some are doing it today.

But what we are doing is allowing the marketplace not just to advantage those who choose to do it within their framework or their four walls of their business, but can do it in a way that these fees can pass back and forth between the small businesses and large businesses.

Senator REED. One of the other concerns that we have heard, particularly from realtors, is that they often have relationships with service providers, whom they know to have high quality and very responsive, et cetera. But if they are not in the package, they can't use these particular service providers. Is that the case?

Secretary MARTINEZ. First of all, I don't believe that would be the case. Second, sir, we do not require packaging. We believe that the marketplace will decide what works best and maybe realtors will—settlement service providers may package. And anybody would be allowed to then provide the service however they best saw fit.

Senator REED. There is another issue here and that is, even with all these innovations, the question is what happens if the individual borrower discovers that they have been misled or that the terms of the package have not been complied with? What is the remedy?

Secretary MARTINEZ. Obviously, I believe there still would be civil remedy. But I also believe that we need, and it is encumbent upon us, to have aggressive RESPA enforcement, which we should do regardless of what happens with the Rule. We have taken that responsibility seriously and continue to believe that we must be able to aggressively enforce. I don't think that it can be only an enforcement remedy, but there ought to be individual enforcement through civil action.

Senator REED. Well, one of the problems, Mr. Secretary, in trying to understand all the ramifications of the Rule, is that the damages are limited, I believe. Is that correct?

Secretary MARTINEZ. No, they are not limited. No, sir.

Senator REED. So what would be the types of damages?

Secretary MARTINEZ. No, it is not limited, no, sir. There would be no limitation on the right of action.

Senator REED. What would be the types of damages that one could collect? The reason I ask that is, if the damages are of small monetary value, yes, you have a civil right. But to vindicate that right, it often costs more than what you will get. And as a result, practically, you don't have that.

Secretary MARTINEZ. I know that well from my days in private law practice.

Senator REED. Indeed.

Secretary MARTINEZ. So, I believe the remedy for civil damages is preserved. I guess the question really goes to whether class action suits would also be permitted. And I am not sure that I can answer that readily. We might need to provide that answer.

Senator REED. I am asking, not advocating the moment.

Secretary MARTINEZ. I understand.

Senator REED. The other issue here too, which you brought up, is the notion that there has to be vigorous regulatory enforcement. And often what we find, Mr. Secretary, and this has been the case not just recently, but throughout my career, is that we pass these rules, and particularly in this area, consumer issues, we don't provide the resources and the oversight for vigorous enforcement.

I think if you are, as you are, quite sincerely proposing that this Rule go forward and it be enforced, then we also have the responsibility to request the resources and the authority and the personnel to enforce it. And I presume that you will do that.

Secretary MARTINEZ. Yes, sir. I think that is part and parcel of what we are trying to do, is to also provide various enforcement.

Senator REED. Thank you, Mr. Secretary.

Secretary MARTINEZ. Yes, Senator.

Chairman SHELBY. Senator Bunning.

COMMENTS OF SENATOR JIM BUNNING

Senator BUNNING. Thank you very much, Mr. Chairman. Welcome, Secretary Martinez.

Secretary MARTINEZ. Senator.

Senator BUNNING. I would like to enter my statement into the record.

Chairman SHELBY. Without objection, it is so ordered.

Senator REED. Mr. Chairman, could I also ask that my statement be included?

Chairman SHELBY. Without objection, both statements will be made part of the record.

Senator BUNNING. You have heard some of the criticisms of your proposed changes. A lot of people think this is big versus little. Many are saying that only large mortgage bankers will be able to package loans. Please respond to that.

Secretary MARTINEZ. Yes, sir. Senator, I know that there is a lot of anxiety in some circles about the Rule, but I think we need to deal with the facts and we need to deal with the certainty of what is being done and not being done.

We should understand that, today, one can create a package product. And if it was that profitable and if the marketplace was driving it in that direction, we would have more of it. All they

would have to do is not do business with someone outside their firm. See, today, they can package as long as the transactions take place with captive companies or people they are in business with.

If we deregulate, if we allow the marketplace to flow freely, then the same packaging can take place. But it can also now take place with that small provider in Tuscaloosa, Alabama. It doesn't just have to be the big banker in Birmingham, just to use an example.

[Laughter.]

Chairman SHELBY. Mr. Secretary, the big banker might be in Tuscaloosa.

[Laughter.]

Senator BUNNING. It is not that far away, by the way, Mr. Secretary. Tuscaloosa is not that far away from Birmingham, as we both know.

Chairman SHELBY. No.

[Laughter.]

Birmingham is a suburb of Tuscaloosa.

[Laughter.]

Secretary MARTINEZ. Okay.

[Laughter.]

Senator BUNNING. I know that you are studying the comments that have come in and have been submitted to HUD on this Proposed Rule. Are you planning on issuing a Final Rule next, or will there be a second interim reflecting comments and improving on what has been submitted?

Secretary MARTINEZ. We have been very, very seriously listening to the comments. We have been seriously modifying our thinking from where we were originally and we are doing so in a very serious way.

So, I believe that our goal would be to issue a Final Rule that incorporates a great deal of consultation with the industry, understanding the concerns and doing the best we can to reach middle ground.

Senator, part of the problem here is that what is great for someone, then impacts someone else. We are trying to reach middle ground. We are trying to do things like, for instance, some have criticized the plan because it does not require disclosure of every single element that might be included in a package.

The fact of the matter is that the AARP has implored us not to do that because they think that that would be confusing to the consumer, to the customer.

So what we are doing is letting the marketplace decide whether the consumer wants that kind of disclosure or not. And let the marketplace either include them or not include them.

We are not dictating that they be all listed or that they not be listed. This is a very Republican thing. We are deregulating. We are letting the marketplace decide where it will flow.

If consumers want that detailed information, they will go to the service providers that give them that information. If they don't, they will just go to the other.

Senator BUNNING. The Chairman brought out that the mortgage brokers have portrayed this Rule as creating what is considered an unlevel playing field. Specifically, they argue that a lender can advertise and show his customers a zero-point loan, while the mort-

gage broker cannot, for the very same loan and/or customer. How do you comment on this?

Secretary MARTINEZ. Senator, what I can tell you is we have been in a very active listening mode to the mortgage brokers. We have been actively trying to change the original form in a very profound way to ensure that the disclosure of their fee does not provide them or put them at a business disadvantage.

I would just challenge you to say that the situation we have today is not good for the consumer. It is not fair that the mortgage fee not be disclosed.

What we need to do is make sure that we require that disclosure. By the way, and if I am in the business, the less disclosure that I have to give, the better it is for me. Is that good for consumers? Probably not.

What we need to do is to find a middle ground that allows disclosure, but not unfairly disadvantages the mortgage broker from being in the business and being competitive against other services that are not through a broker.

The fact is, in most mortgage businesses these days, more than half, I believe, are done through brokers. They play a very important role. The big banks, the feared big banks rely on the brokers and their flexibility, their local contacts, and all of that, to reach the consumers. And I believe that that will continue.

Senator BUNNING. The last comment that I want to make is that the housing industry itself has been a stalwart through all the problems that we have had. I have had no one knocking down my door to change the rules and regulations. So, I want to create no harm here—no harm, no foul. I hope you keep that in mind when you are writing your final regulation.

Secretary MARTINEZ. Yes, Senator.

Senator BUNNING. Because the housing industry has been one of the very, very few industries, and those servicing the housing industry have been one of the very, very few industries that have been stalwarts in this 3-year underperforming economy that we have had.

Thank you very much.

Secretary MARTINEZ. Thank you, Senator.

Chairman SHELBY. Thank you, Senator Bunning.

Mr. Secretary, to follow up, disclosure is important to me, and I think it is important to most consumers.

Whether the AARP might think it would confuse consumers, I don't think so. I think most consumers want to see what they pay, who gets what. I have seen that for a long time.

Let's go back to the originators of loans. The originators of loans, as we know, are not portfolio lenders. They originate for the secondary market. You alluded to the secondary market.

Secretary MARTINEZ. Yes, Senator.

Chairman SHELBY. To Fannie Mae, Freddie Mac, and so forth. Are you saying that they have no idea that they are going to sell the loan and what they are going to get for it?

They have this working relationship with both Fannie Mae and Freddie Mac. They know just about everything before they even give a commitment to me or you for a loan, what they are going to sell that loan for, what they are going to get. So disclosure for

the consumer, not just in housing, but in everything, I think it is important to put it on the table. That is just one of the aspects of disclosure.

Secretary MARTINEZ. I understand.

Chairman SHELBY. We shouldn't hide things.

Secretary MARTINEZ. Correct. And I would assume that it wasn't hidden. The problem I have is that, the Rule I am dealing with only touches the settlement process.

Chairman SHELBY. We understand.

Secretary MARTINEZ. This is not a transaction at the table.

Chairman SHELBY. We know.

Secretary MARTINEZ. The second thing I would point out is——

Chairman SHELBY. But it has to do with, when you buy a piece of property and you are borrowing money, that is the most important decision in most people's lives, buying property.

Secretary MARTINEZ. Senator, the most impacted people in this are the mortgage brokers. And what I would say to you is that, in our conversations with them, and in our give and take with them, they provided us with a proposed GFE declaration. And in that, they did not provide a disclosure for the banker's fee, as such. So, we want to work in a way that provides fairness to all of this.

Chairman SHELBY. Well, we want to work with you. But I think you are rushing this Final Rule too hard. I will get into this as we go along.

Secretary MARTINEZ. Sure.

Chairman SHELBY. I hope you will listen because, at the end of the day, I think you could get a lot of constructive comments from these hearings, both in the House and in the Senate, from everybody because, as Senator Bunning says, I know you fairly well and we are friends. But, gosh, don't do any harm out there.

Secretary MARTINEZ. Absolutely.

Chairman SHELBY. And if you are going to hide things from the consumer and you are not going to disclose everything, I think that is off to a bad start.

Secretary MARTINEZ. Senator, I agree with you completely. The importance of the housing market to this economy is very profound and very important. This Rule could be blamed for a lot of things. But hiding would not be a part of it, I don't believe, necessarily.

Chairman SHELBY. Let's disclose everything and not hide things.

Secretary MARTINEZ. To the extent we can——

Chairman SHELBY. If you don't disclose, you are hiding.

Secretary MARTINEZ. Senator, your question almost gives the inference that we are purposely looking not to disclose a given fee to advantage someone in the relationship.

Chairman SHELBY. I don't know what is out there. But I think if you put everything on top of the table, Mr. Secretary, people see what they are paying. I see nothing wrong with that.

Secretary MARTINEZ. There is nothing——

Chairman SHELBY. But I do see things wrong when you don't disclose everything.

Secretary MARTINEZ. I don't have authority under the RESPA Rule to provide or to require disclosure of a fee that doesn't take place at the time of closing. If you find me a solution to that——

Chairman SHELBY. Well, we might be able to do that.

Secretary MARTINEZ. —I will be happy to.

Chairman SHELBY. We might be able to.

[Laughter.]

That is what this Committee is about, among other things.

Secretary MARTINEZ. Absolutely. And that is the problem that we are dealing with, just so you know.

Chairman SHELBY. That is why I ask you to slow down. Because I have a number of questions.

Secretary MARTINEZ. Yes, sir.

Chairman SHELBY. In a comment letter to HUD, the Federal Trade Commission argued that the proposal's broker compensation disclosure requirement could—and I am now quoting—"Confuse consumers and lead them to misinterpret the overall cost of a transaction." This is the Federal Trade Commission.

Further, the Federal Trade Commission warned that the proposed changes that you have brought about in the Proposed Rule may not increase customer welfare as much as HUD intends. And in the worst case, Mr. Secretary, may actually result in consumer harm—the same words that Senator Bunning alluded to.

The Federal Trade Commission noted that since the disclosure requirement only applied to mortgage bankers, and not other originators, it will result in an asymmetric disclosure of compensation that could hamper competition between brokers and other originators and confuse consumers.

Secretary MARTINEZ. The FTC, I am told, supports the Rule in general. In fact, they filed a response to our proposal stating that the proposed packaging initiative will enhance competition and will ultimately lower the cost of settlement services for the consumer. In fact, we are working actively with the FTC in testing the GFE.

Chairman SHELBY. So are we. We want to do that, too.

Secretary MARTINEZ. So while I understand those comments, I think they also have issued some more supportive comments also. But we are in this thing together and all we want to try to do is to come up with a good product.

Chairman SHELBY. I have a number of other statements and questions.

How do you square this criticism from the FTC with your claim that the reclassification of brokers' fees would create greater clarity for consumers and permit them to comparison-shop, enhancing the competition? You see, they are raising this question. Not me, but they are.

Secretary MARTINEZ. Right. I think, sir, that part of what they were concerned about was the individual disclosure items, as you were suggesting, what I would call the pickle and the hamburger. You go to a McDonald's, you get a hamburger for a dollar. Do you need to know how much the pickle costs? Are you concerned about how much Burger King charges for a hamburger?

Chairman SHELBY. I think that is a false analogy.

Secretary MARTINEZ. It may be. But the point is that what this Rule does——

Chairman SHELBY. You are a smart man. You can come up with a better analogy than that.

[Laughter.]

Secretary MARTINEZ. I thought it was pretty good, actually——

[Laughter.]

—but I now know better. Now, I know it isn't.

[Laughter.]

But, anyway, I think that the Rule, the way we have it framed, allows for someone to do just that and provide the itemization.

Chairman SHELBY. Sure.

Secretary MARTINEZ. However, I want to hear your concerns and others. And if that is the issue that would make a big difference in a lot of people's minds and doesn't necessarily create what some would view as a disastrous situation, maybe it is something that we should consider requiring. Right now, we have been of the view that it would be more confusing and less desirable.

Chairman SHELBY. Mr. Secretary, what I am trying to get at here, I am not talking about packaging. Packaging might have a lot of merit. Who knows? I am talking about broker disclosure.

Secretary MARTINEZ. Okay.

Chairman SHELBY. Mr. Secretary, broker disclosure is what I was trying to get at.

Secretary MARTINEZ. Broker disclosure currently, Mr. Chairman, is not—when you think about what got me into this RESPA, you might wonder, why in the world would this fellow decide he would want to get himself in the middle of this mess?

Well, you know, it is about the desire to make a difference, to do something right to help people. I was confronted with the issue of broker abuse.

Chairman SHELBY. That's right.

Secretary MARTINEZ. I was confronted with the problem of yield spread premiums. And I was confronted with a series of lawsuits that were threatening the very things we are talking about, the housing industry, the liquidity of the banking.

Chairman SHELBY. Absolutely. We talked about that.

Secretary MARTINEZ. Mortgage banking services. And I felt it was important for us to clarify HUD's long-standing Rule.

The result of that was that there were very many groups, and in fact, the Senator in the majority at that time and the Chairman of this Committee, was very upset with me because of what he felt was that I had destroyed the ability for there to be civil remedy in a class action sort of way to enforce or to try to prevent the broker abuse upon consumers.

Once I did that, which I thought was the right thing to do, which was something that benefited the broker industry greatly, as well as the mortgage banking industry, I felt that the job was not done, that we needed to do more to fulfill our commitment to ensure that the consumers were well-informed in the settlement transaction.

That is why what today is rampant abuse, yield spread premiums in the brokerage industry, is something that I believe disclosure of brokerage fee and providing the consumer with the knowledge that they get a yield spread premium to use toward their downpayment, I felt needed to be done.

So what we are doing is responding to the marketplace, not to theory, but, in fact, to the marketplace and the circumstances that existed.

Chairman SHELBY. I don't have any quarrel with what you are trying to do. And I think that is what we need to do, to a point.

We want you to disclose everything. We don't want you to hide anything.

How were the savings calculated that you are talking about would come up? And can you itemize the estimated savings? Last, and I think this is important, are you sure the savings that you projected will go to the consumers? If they are going somewhere else, the consumer is not ultimately going to benefit.

There seems to be agreement among some of the people that your proposal would favor larger institutions and, as a practical matter, would only be available to lenders. This is one of the deals that the small business community has pointed out, as you know, Mr. Secretary.

Secretary MARTINEZ. Yes, Mr. Chairman. And I think, unquestionably, when we have a Rule that we believe will save the consumer $700 per transaction, that $700 doesn't come out of thin air.

Chairman SHELBY. Can you furnish how you arrived at that to the Committee?

Secretary MARTINEZ. Yes, sir, we can, and we would be happy to do that in a written form.

Chairman SHELBY. Absolutely.

Secretary MARTINEZ. We will be happy to have our folks do that.

Chairman SHELBY. We will have our economists look at that.

Secretary MARTINEZ. Right. The fact of the matter is that we do believe that it will result in savings. So if it results in savings, Mr. Chairman, it also results in a loss to someone that today provides a service that perhaps is not priced at a competitive rate.

Chairman SHELBY. We are interested in competition, aren't we?

Secretary MARTINEZ. Exactly. What I would like to do is rather than try to run through figures that may or may not be completely accurate, is provide you in writing our economic analysis of where the saving comes from.

Chairman SHELBY. I am going to go back to something that we were talking about earlier, whether HUD has some jurisdiction of secondary market compensation dealing with RESPA.

Secretary MARTINEZ. Right.

Chairman SHELBY. The secondary market compensation is not outside of the RESPA Rule. HUD has granted an exemption to the secondary market transaction. And if you choose, you can take that exemption away.

Secretary MARTINEZ. If that is correct, it is something that we should address.

Chairman SHELBY. I have been told that by counsel.

Secretary MARTINEZ. I think that a secondary problem to that, and maybe they can help us to clarify, is the fact that the transaction of the banker with the secondary market doesn't take place at closing. In fact, it is not known at closing.

I understand what you are saying, that there are arrangements. But banks sometimes sell their loans off, sometimes they don't. Sometimes they sell it to one, sometimes they sell it to another. How much that fee is, it is not a fee that is known at closing.

I understand the need to disclose it, and if we can find a way to disclose it, I see no harm in that.

Chairman SHELBY. Well, I just believe that total disclosure is more healthy than not disclosing the fee.

Secretary MARTINEZ. And I agree with you on that.

Chairman SHELBY. Mr. Secretary, recent trends in the marketplace have seen a doubling of market share by the top mortgage providers, from approximately 25 to 56 percent of the market.

There is general concern about the overall effect of the Proposed Rule on competition here. Specifically, there is a concern that the Rule will result in even greater consolidation in the market and the loss of many small-business providers. How do you answer that there will be out there competition, that the mortgage business will not be controlled, say, by eight or ten big people, as opposed to everybody else, where there is so much competition today?

Secretary MARTINEZ. We share that concern. We don't want to see that happen. That is not at all our intent or goal.

We believe, Mr. Chairman, that through the reform we are proposing there will continue to be a healthy marketplace for small service providers because they are in the local communities. It wouldn't make sense to only furnish these services through a big bank relationship. The local broker knows the consumers, knows the marketplace.

We see, in fact, a trend toward more use of brokers than we have in the past. And that I think speaks in the other direction.

Lenders could buy up settlement services companies now, title companies, appraisers, and everybody else. And they don't do it because it really doesn't appear to be in their best economic interest. So the Rule is not going to change that possibility or that fact of the marketplace which appears to be today.

Banks are making fewer loans than they used to. Brokers now originate 60 percent of all loans. And that is a change that has taken place just over the last 10 years. So that trend would suggest that the viability of the broker in the relationships with the consumers is an important one and one that seems to be not losing, but gaining, favor.

Chairman SHELBY. I want to get into another area, the exemption from Section 8 prohibition on referral fees and kickbacks.

Mr. Secretary, one of the biggest concerns that I have with your Proposed Rule—safe harbor provision for lenders who provide settlement services packages—is this. I am concerned about the effect that such an allowance will have on the abilities of lenders to hide fees and further prevent consumers from effectively shopping among settlement service providers.

Your Rule does not require—we have already been talking about this some—a detailed disclosure of costs for each settlement service, but, rather, a bottom-line price for all services provided.

In his testimony before the House Small Business Committee, Assistant Secretary Weicker stated that small settlement service providers could arguably compete against the larger lenders that package services and that consumers could request a specific service provider be used in the transaction if they wished.

Mr. Secretary, how does a consumer shop among settlement service providers if the cost is not disclosed within the package? In other words, if they don't know, how would they compare, how would they shop? I think this would make it impossible for them to compare.

Secretary MARTINEZ. Mr. Chairman, the marketplace would allow them to then choose a service provider that was giving them the kind of disclosure that they felt was better for them. In other words, RESPA——

Chairman SHELBY. But if they don't know, sir, if they don't know, and they are not given the information to begin with——

Secretary MARTINEZ. They would go to a provider that was giving them that kind of detailed information. There would be one out there if the consumer—if you believe in the marketplace and the way it functions, if that was something that consumers wanted, if that was something that the marketplace wanted, there will be someone who will provide it and they can go to that type of provider that is giving them the details of every piece of the transaction and they can choose to do business there.

Chairman SHELBY. But what if there are no providers other than the package people?

Secretary MARTINEZ. Mr. Chairman, that is just not——

Chairman SHELBY. I guess what bothers me and others, is less disclosure better for consumers? If it is, I have never heard of that in my life.

Secretary MARTINEZ. I hear your point of view. It is something that we can remedy if that was felt to be the better way to go. And that is why this process is important. The only reason not to disclose is because most of the comments from those who represent the interests of the consumer have been to the effect that what they want is to see the bottom-line number.

Most people, as I hear anecdotally about their experience at the settlement table, what they have is an overwhelming amount of paperwork with little information.

So, they want a bottom line—what is it going to cost me?

Chairman SHELBY. I believe they want information.

Secretary MARTINEZ. Well, and that may be true, and that is why we allow it.

Chairman SHELBY. And then the bottom line.

Secretary MARTINEZ. We don't prohibit it. We allow there to be that kind of disclosure.

Chairman SHELBY. If I go to the grocery store, each item is itemized. As a matter of fact, I have gone through it to see if I got what my wife sent me to get.

[Laughter.]

Each item is itemized. It takes just a minute or two.

Secretary MARTINEZ. Mr. Chairman, if I may comment on that.

Chairman SHELBY. Sure.

Secretary MARTINEZ. When I go purchase a vehicle, I am not real concerned how much the transmission costs GM. I am more concerned with what that bottom line is, and then I ask the fellow, tell me what I am going to have to write you a check for.

Chairman SHELBY. That is a little different.

Secretary MARTINEZ. Well, sir, I don't know that it is so different.

Chairman SHELBY. Now wait a minute.

Secretary MARTINEZ. Because if you are buying one of those——

Chairman SHELBY. I think your analogy would be, a man might not be interested in what the 2x4's cost in the house he is buying,

but he is interested in the total cost of the house, just like a car is a final product.

Secretary MARTINEZ. You may be paying for one of those fancy Mercedes that is made in Tuscaloosa as much as someone would be paying for a house.

[Laughter.]

Chairman SHELBY. I wish I could, but I can't afford it.

[Laughter.]

Secretary MARTINEZ. I say, one would be.

Chairman SHELBY. My car is 20 years old.

[Laughter.]

Secretary MARTINEZ. But if you purchase a vehicle, and that is a fairly large transaction, you want to know ultimately what it is going to cost you to walk out of there or drive out of there in your new vehicle.

You should have that same kind of opportunity to purchase a home knowing the day you commit to buy it, the day you get your mortgage loan, what you are going to pay 3 months later when you sit down and write your final check.

Chairman SHELBY. I might not be interested in what the transmission costs or what the plumbing in the house costs. But I am interested in the bottom line. I am interested in what those transaction fees are for a car, for a house, a mobile home, appliances, or whatever.

Secretary MARTINEZ. But if I may just continue on this.

Chairman SHELBY. Sure.

Secretary MARTINEZ. If you were to go purchase a home and you knew your closing settlement costs were going to cost you $1,500, and that was the bottom line, is that more important than knowing how much the title insurance was, how much the bug inspector costs? Ultimately, you want to know what it is going to cost you.

Chairman SHELBY. I want to know the parts and then the whole.

Secretary MARTINEZ. You would then shop for a provider that was going to give you that kind of detail.

Chairman SHELBY. I might.

Secretary MARTINEZ. You would.

Chairman SHELBY. It depends on how the costs were.

Secretary MARTINEZ. And you could. You would ultimately want to know what it is going to cost you, too.

So, we now provide the opportunity for the marketplace to give you that kind of detail or not give you that kind of detail, either way to give you a bottom-line price, and that is very good for the consumer.

Chairman SHELBY. Ultimately, though, the consumer needs to know all the costs and they need to be able to shop, go somewhere else, don't they?

Secretary MARTINEZ. The question is what does the consumer need in order to shop? What they need is a guaranteed price. What they need is to know with certainty early on. What they need is for the GFE not to change at closing dramatically. And what they need is to know what the bottom-line settlement costs are. That is what I think.

Chairman SHELBY. They also need to know the parts, how you get to that bottom line, where there is nothing hidden.

Secretary MARTINEZ. And the Rule we are offering provides that for the marketplace to do, if they so choose.

Chairman SHELBY. Let's don't just hide anything. I want to ask you this, Mr. Secretary. I have a number of things.

You assume a savings of about $1.8 billion here. Could you furnish us the basis for all this where we can analyze this?

Secretary MARTINEZ. Yes, sir. We will provide you with the economic analysis of all of that.

Chairman SHELBY. Okay.

Mr. Secretary, in your testimony before the House Small Business Committee, you state on several occasions that this proposal was one of deregulation and that the proposal deregulates the field. What kind of deregulation increases the regulatory burden by 2½ million burden-hours, which was outlined in HUD's Paperwork Reduction Act submission on this to OMB?

Secretary MARTINEZ. Sir, that would be purely in the transition cost. That is the cost of going from a system that has been ingrained for many years.

Chairman SHELBY. It is still a lot of hours, isn't it?

Secretary MARTINEZ. Yes, sir, it is.

Chairman SHELBY. But before the House Small Business Committee, HUD characterized this 2½ million hour burden as one-time transition costs, as you just said.

Secretary MARTINEZ. Correct.

Chairman SHELBY. Isn't it something like 285 years or, essentially, three centuries? That is assuming 24 hours a day, 7 days a week. That is a long transition if you put it into this. It doesn't sound like deregulation to me. I am just raising these points that the Small Business Committee in the House raised the other day.

Mr. Secretary, we are all a believer in homeownership and what it means.

Secretary MARTINEZ. Correct.

Chairman SHELBY. The impact it has on families and communities is well-documented. The mortgage broker industry provides an invaluable service to minority homeowners, homebuyers in the rural communities all over the country. And in the big cities, too.

Over half of all mortgage loans in this country are originated by brokers, which you said a minute ago. The numbers of percentages are higher amongst minority families.

How will this Proposed Rule change positively affect the homebuying process, especially in the minority community, where we are trying to push homeownership more and more because they have fallen behind?

Secretary MARTINEZ. The first way we will do it is by lowering the cost by $700, which is going to make that many more people able to go to the closing table and buy a home of their own. We have a very active program of helping people with the downpayment as a key component of getting minority families into homeownership.

Chairman SHELBY. We worked together on that.

Secretary MARTINEZ. Correct. And I appreciate your cooperation and help on that. By lowering the costs by $700, it is going to make that many more people able to do it.

Chairman SHELBY. Will the consumer get that $700? That I think would be the central question. If you assume that what you say is true, would it be passed on to the consumer or would it go to somebody else?

Secretary MARTINEZ. We think competition will drive it to the consumer. We believe that that will be possible.

Chairman SHELBY. If there is less competition, then there are fewer choices.

Secretary MARTINEZ. Correct. But we also believe that there will continue to be competition.

In addition to that, they will still be able to do business with the broker. It is just that now, they will know exactly what they are paying the broker and they will not be as likely to have the yield spread premium for which they are paying a higher interest rate be utilized as broker fee. There will be a number of things that will come about as a result of this that I think will improve the climate.

Chairman SHELBY. Mr. Secretary, I have talked about the Small Business Committee hearing last week. I have seen the transcript. Frankly, it was not a pretty hearing. I say this because——

Secretary MARTINEZ. Sir, if I might say, I also find this hearing to be far more respectful, even though we are disagreeing at times.

I thought Mr. Weicker's treatment last week at that hearing was not worthy of a public servant in the U.S. Government.

Chairman SHELBY. But I say this because it reinforces what I believe is a very serious problem HUD has on this Rule. I keep going through this because I think if we could work together on this, and if you wait until we conduct our hearings and hear everybody and then think about going back to a Final Rule, because if you do, I think you are making a mistake. I say that out of respect to HUD.

Secretary MARTINEZ. Mr. Chairman, I don't know why there is this feeling that——

Chairman SHELBY. Rushing through.

Secretary MARTINEZ. —rushing. In fact, when we were closing the comment period, because it had to have a closure, we received more comments, as you well pointed out, than there has ever been in the history of comments. The thought was that we should leave the comment period open even longer. I am reluctant to just delay for the sake of delay.

Chairman SHELBY. Not interested in that.

Secretary MARTINEZ. And allow that to be a way of defeating the Rule change. But I am also very interested in working with you. I have a wonderful relationship with you. I respect your judgment greatly, and my door is open to you and others to continue the conversations.

Chairman SHELBY. I know that.

Secretary MARTINEZ. So this is not going to be a rush to judgment, if I may interrupt you, to say that.

Chairman SHELBY. The SBA Office of Advocacy determined that your Agency, HUD, did not sufficiently calculate the cost of the Proposed Rule on small businesses, and recommended that you issue a supplemental RFA to meet your obligations under the Act.

I cannot imagine how you could go forward with a Final Rule without stepping back, looking at what a lot of the issues have been that have been raised, and doing the basics which are nec-

essary, I believe absolutely necessary, to support a Proposed Rule, much less a Final Rule.

I see nothing, Mr. Secretary, absolutely nothing that I am aware of that compels you to push forward like on a calendar for a Final Rule here. Especially with all the hearings that will be going on concerning this.

Indeed, the level of concern, the lack of certainty over both the costs and benefits of this Rule would seem to dictate a revised Rule that more accurately considers all these issues, some of which we have raised and will raise in the next few weeks.

In addition, a revised rule allows the small business community and other stakeholders, consumers, an opportunity to appreciate the real cost and potential benefits to have additional comments before a Final Rule is adopted.

Otherwise you are saying to us, Mr. Secretary, and out of all due respect, and we have a good relationship, just trust us and we will go on and issue the Rule. But that is not our job, to just do this. We have an obligation in the Congress and on this Committee to scrutinize these rules, and that is what we are doing. So, I think it is imperative that you work with us, and I believe you will, that you do not rush to judgment here. And in a good-faith effort, try to adjust and take into consideration the concerns that you have put forward.

Disclosure I think is absolutely crucial—disclosure of everything. Hide nothing from the consumer.

I am just not one that has ever wanted things hidden from me, and if I am the average consumer, I will figure it out one way or the other.

But if it is hidden, they never figure it out. And nothing should be hidden. Mr. Secretary, I hope you will work with us on this, that you will not rush to judgment because we contemplate at least one or two more hearings on this Rule here in the Senate Banking Committee. And I know maybe the Small Business Committee, the House and others do, too.

Secretary MARTINEZ. Thank you, sir. I will only say that I have no desire to do this.

I don't think the way that we have approached this Rule should suggest to anyone that we are unwilling to listen, that we are unwilling to work with people.

It bothers me greatly, frankly, to have groups that we have been closely working with to try to accommodate their concerns continue to act as if nothing was being done to help them. That is a problem. There really should be an understanding by the Chairman that we are very, very diligently listening actively and evolving our thinking as we hear concerns.

Therefore, sir, we continue to do that and will continue to do that. If it appears that full disclosure is the way that this should go, I have no reason to want to not do it. And so, we want to make sure that as we go forward, we continue on a pace that allows—just like we did with the comments, Mr. Chairman. At some point we had to close it. But we had all the comments in the world that we could want. We have worked actively to listen to the comments, to read them, and to not only do that, but to also incorporate a lot of good ideas that we've received from those in the marketplace.

What I say to our folks is, we need to hear from the people out there doing these settlements. We need to hear from the people in business so that we can do something that enhances how business is done. But also, we need to hear from consumers and how they feel that they can best be represented through the process.

So, I just would reiterate to you that we continue to listen and we look forward to working with you and with others.

Chairman SHELBY. I hope you will want to do it right, to have a public process and comment period because we in the Congress are now involved in this, as we should be. And I would hope that you would issue the Rule and put it all on the record because there is going to be a lot more there for you to consider.

Senator Sarbanes.

COMMENTS OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Mr. Chairman.

Mr. Chairman, I wasn't here at the outset.

Chairman SHELBY. That's okay. You go right ahead.

Senator SARBANES. I would like to take advantage of this and make a brief opening statement.

Chairman SHELBY. Secretary Martinez was also tied up in traffic earlier this morning.

Senator SARBANES. Okay.

Chairman SHELBY. Traffic is tough.

Senator SARBANES. It happens to all of us.

Chairman SHELBY. Yes.

Senator SARBANES. Mr. Secretary, I want to commend you for undertaking this very difficult, complex, and obviously controversial task of improving the mortgage origination process. It has become something of a sport on the part of many I think to belittle the Real Estate Settlement Procedure Act, RESPA. It seems to be a favorite pastime now of a number of groups. But I think it is worth reminding people that the law helped bring order and equity to a process that was suffering from rampant kickbacks and referral fees among settlement service providers. That was what prompted the enactment of RESPA in the first place. Those side payments clearly resulted in higher costs for consumers. For many years, RESPA has served consumers well by aligning market incentives with the interests of borrowers. And I think the result has been a stronger and more effective real estate market.

Now in my view, RESPA can continue to play this valuable role if the regulations are updated to address new issues as they arise. HUD has put a proposal on the table that it hopes, or it is putting forward with the objective of achieving this goal. In my view, if done correctly, the Proposed Rule holds out the prospect of resulting in significant good. If not done correctly, it would result in significant harm. And I am anxious to work with the Secretary and the Department to ensure the better outcome.

As you well know, a number of us on the Committee have sent you a letter outlining what we think are the essential elements of a Final Rule. The key principles that are included in that letter are as follows, and I want to take just a moment to touch on them.

First, the Rule must not undermine existing RESPA or Truth in Lending Act protections for subprime borrowers. Subprime bor-

rowers are far more likely to be subjected to predatory practices against which RESPA and TILA provide at least some remedies. And we want to be sure that those protections are preserved in any Final Rule.

Second, the additional protections or rights that the Proposed Rule would create may be of little use if they are not enforceable. I differed with the Department on its clarification earlier in 2001 because I thought it undercut the ability of consumers to seek redress against illegal yield spread premiums and, of course, you are trying to address that issue now in your Rule. It is clear by studies that at least half of those yield spread premiums are not used to offset closing costs as it was asserted would be the case. In my view, your proposed changes in the treatment of yield spread premiums, as well as your proposals for a Guaranteed Mortgage Package, should allow for effective enforcement, including private enforcement.

Third, a Final Rule must be careful not to allow the "bait and switch" tactics. The Guaranteed Mortgage Package should include an interest rate, and be contingent only on the confirmation of information provided by the borrower, so that they cannot be led down the path and then have a surprise sprung on them. If done in this way, and if limited to the prime market, the Guaranteed Mortgage Package has the potential of significantly improving the outcomes for consumers.

Finally, the Rule should not preempt State laws. For example, a number of States have laws that require brokers to act as agents for the borrower. I don't think HUD should undermine those laws.

I won't go on to repeat other matters contained in the comment letter. Let me simply say that, at the very least, I think it is imperative that you go forward with the proposal to ensure that brokers tell the consumers, upfront, what they charge, and "Ensure that the yield spread premiums are fully disclosed to consumers, that consumers determine whether and how to use them, and that consumers receive the full benefit of any such payment."

The whole rationale that the consumer is led into a higher interest rate is to offset the closing costs. Now if they are not aware of that or can't exercise that option, they are led into a higher interest rate, and instead of that amount going to offset the closing costs, it goes to the person who led them into the higher interest rate, clearly working directly against the consumer's interest.

Let me just close my statement by saying that I am supportive of the goals the Secretary has expressed, and some of the steps that he is seeking to take to achieve the goals. I appreciate this is a complex issue. I know that you are being flooded with comments, to some extent kind of being battered around, which is always what happens when you set out to try to do the right thing.

I look forward to continuing to try to work with you and your staff to see that we can come up with a Final Rule. And I encourage all of those that are standing in line to beat up on the Secretary, to sort of take a view that, look, there are some problems here. In fact, I don't know of anyone that denies that there are at least some problems, and the focus of attention, it seems to me, ought to be directed toward trying to solve those problems so that we can move forward in this area.

Let me just ask a couple of questions, if I may, Mr. Chairman.

Chairman SHELBY. You go ahead, Senator.

Senator SARBANES. In a briefing earlier this week that was given by HUD, your staff characterized yield spread premiums as the borrower's money because consumers are paying the yield spread premiums through a higher interest rate. I take it you agree with this characterization.

Secretary MARTINEZ. Yes, sir, I do. Unfortunately, as you pointed out in your comments, all too often, some brokers view this as their money, which is very, very wrong.

Senator SARBANES. Yes. Actually, both the industry and consumer groups seem to agree that the yield spread premiums are a necessary tool to allow people to take out low- or no-cost loans. The broker advances closing costs on behalf of the borrower and then gets reimbursed through the yield spread premium. But if you take that approach, shouldn't the yield spread premiums go to offset closing costs on a dollar-for-dollar basis?

Secretary MARTINEZ. In my opinion, they should.

Senator SARBANES. Yes.

Secretary MARTINEZ. The broker fee should be one thing, the yield spread premium is an offsetting of a higher interest rate in order for the broker or for the consumer to have his up-front costs paid for. In other words, it is blending into the loan the up-front cost of the loan.

Senator SARBANES. Actually, the industry people, when pressed on this, concede that. It is hard to develop any rationale.

The broker charges a fee for his services. The whole concept of the yield spread premium is someone agrees to do a higher interest rate in order to offset the closing costs. Now if you don't offset the closing costs with a higher interest rate, there is no underlying justification for that, is there?

Secretary MARTINEZ. There isn't. And just to show you how distorted the current system is, which is why we are doing this in the first place, you know. This isn't for fun because it isn't much fun.

[Laughter.]

But to have among us 43,000 comments, letters from brokers saying, you are not going to take the YSP from me. That is how I make my living.

Well, you know, there is something very fundamentally wrong with that person's understanding of the yield spread premium. If you give that to the borrower, how do I get my fee? That is my fee.

Senator SARBANES. Yes.

Secretary MARTINEZ. Well, that is not what I understand the yield spread premium to be. So that just goes to show you the level of misuse and misunderstanding that there is out there.

Senator SARBANES. And the consumer generally doesn't know what is happening. Isn't that the case as well?

Secretary MARTINEZ. That is absolutely the case.

Senator SARBANES. Now let me go to the enforcement issue.

I am concerned that we have a sufficient opportunity for private enforcement with respect to these problems. Including class action suits since often, the amount of money that is at stake to the individual is fairly small.

So if you are the plaintiff in that situation, there is not enough at stake to justify taking action. If you are on the other side, recovering a small amount from a lot of people, it is a big chunk of money. And the only way it seems to me that you can even up that equation is to allow on the plaintiff's side the aggregation of all of these small claims so you have a sufficient amount at stake to make it worthwhile to bring action.

I think it is very important for the Department to keep that in mind as they consider how these matters are going to be enforced.

Secretary MARTINEZ. I agree with you, sir. I understand the private enforcement, the right to civil action should be preserved. I don't think that there is an effective enforcement mechanism that we can devise from within. We could never police every transaction. We could never have enough resources devoted to effective enforcement. I think a private enforcement right of action should exist.

Now, I am not certain how I can make that happen through the RESPA Rule. And if there are suggestions along those lines, I would like to hear them. Although I don't know whether that needs to have a right of action derived from law or how. But I understand the concern and I am aware of it. I am just not sure how I can provide a class action right of action through rulemaking.

Senator SARBANES. Let's work at that problem.

Secretary MARTINEZ. Yes, sir.

Senator SARBANES. Because I think it is important.

Mr. Chairman, my time is up and I appreciate your generosity.

Chairman SHELBY. Mr. Secretary, we appreciate you coming here today. Excuse me. I didn't see my good friend. I have blinders on.

Senator SUNUNU. Well, it is a small State and I am way down here at the end.

[Laughter.]

Chairman SHELBY. But an important State.

[Laughter.]

And an important Senator, Senator Sununu.

Senator SARBANES. There are those who love it, correct?

[Laughter.]

Chairman SHELBY. Absolutely.

Senator SUNUNU. There are a few.

Chairman SHELBY. Including the Chairman of the Committee.

[Laughter.]

Senator Sununu.

COMMENTS OF SENATOR JOHN E. SUNUNU

Senator SUNUNU. Thank you very much, Mr. Chairman.

Chairman SHELBY. Take as much time as you need.

Senator SUNUNU. I will try not to belabor any of these questions. And I know a lot of them have been covered. In fact, my first question was going to be whether you were having fun.

[Laughter.]

But you touched on that already. So, I will move right on to the technical stuff.

[Laughter.]

Why don't I pick up on yield spread premiums? Could you discuss the extent to which you have modified the proposal, if at all,

to deal with any of the concerns that were raised regarding yield spread premiums during the comment period?

Secretary MARTINEZ. Yes, sir. What we have done is, of course, required the disclosure of broker fees and we disclosed the yield spread premium as belonging to the consumer, to the borrower.

We were concerned by the comments that mortgage fee disclosure would disadvantage brokers unfairly and we have been diligently working to incorporate suggestions made by the industry on how disclosure of their fee could be accomplished in a way that does not unfairly disadvantage the industry.

Senator SUNUNU. Do you have any specific examples, though, of the suggestions that they have made to level that playing field?

Secretary MARTINEZ. We could provide you, or I am sure that they could provide you with their suggestions. The rulemaking process doesn't allow me to just publish something that isn't really part of the Final Rule on a piecemeal basis. But suffice it to say that we are actively engaged in the process with the industry and I am sure that we can provide you with some of their suggested reforms to the original disclosure that we had anticipated doing.

Senator SUNUNU. Regarding the proposal on packaging, I have heard a suggestion made that HUD doesn't have the authority to enact a requirement on packaging. Could you discuss that a little bit, whether you have the authority and where it is derived from?

Secretary MARTINEZ. Yes, sir. Currently, what we have is a situation that the Rule prohibits packaging. What we are seeking to do is to deregulate that and to permit the marketplace to determine if packaging was an option that they chose to utilize.

Packaging exists today, but it doesn't exist in the freer form, which is now you can package services. You can provide them to a consumer, and some do. But in order to do that and to not run afoul of Section 8 of RESPA, they must have a captive set of services within the company, so the fees are not exchanged with people that are not part of that same business.

Now with the deregulation of Section 8, it will permit the marketplace to determine if and when they chose to package. You could package or you could not package. If you packaged, you could now utilize small service providers that are not necessarily captive of your company.

So, you could then have a freer flow of participation——

Senator SUNUNU. You would access those small businesses, those small providers, through your lender, however.

Secretary MARTINEZ. That is correct. Or whoever formed the package. It could be a lender or it might be someone else that decides to package services. It could be a settlement service provider. Brokers, in fact, I hear are talking about how they might come together to package services themselves and compete in the package environment.

It would be a change in the environment, which makes people very nervous. But it also would have the effect that the marketplace always has, which is to lower the cost to the consumer and provide innovation and more ways of getting the work done.

Senator SUNUNU. How will HUD's role on enforcement change with the new rule? How does HUD intend to enforce the new rule?

Secretary MARTINEZ. We will beef up our enforcement. But beyond that, it is not going to dramatically change how we enforce. We have doubled the staff already and are still in the process of hiring even additional staff in that enforcement arena.

Senator SUNUNU. At the risk of sounding contrarian, it would seem to me that one of the objectives of the new rule should be that the new rule would be easier to enforce than the old rule, which might not require a doubling of the staff.

Secretary MARTINEZ. Actually, we need to do better at enforcing RESPA and we should be doing that regardless of the rule change, and we are in that process. I think the best way this is going to allow for enforcement is by making a better informed consumer with more information and the opportunity to compete.

In other words, to be able to shop apples-to-apples source of comparisons. Right now, a consumer is inundated with information, but given very few choices when they go to the settlement table.

So, we believe that there will be actual self-enforcement in the marketplace of RESPA.

Senator SUNUNU. Well, let me at least place myself on the record as being in favor of apples-to-apples.

[Laughter.]

But regarding that point, it does effectively set up a dual system for disclosure, either to go through the Good Faith Estimate or through packaging.

Secretary MARTINEZ. No, there would always be a Good Faith Estimate. The Good Faith Estimate would be a far better one that there used to be because it will have stringent tolerances to allow someone to have some certainty when they go to the settlement table of what they have to pay. But in addition to that, it will permit packaging of services in a broader context than today is only possible through large corporate arrangements.

Senator SUNUNU. So going through someone who is packaging these services will not make it any more difficult to compare the actual cost to the consumer to a situation where they are not packaging?

Secretary MARTINEZ. No, because I think that ultimately, the consumer will know a bottom-line price. And if they know a bottom-line price, they could compare that price to the competitor and make a choice.

Senator SUNUNU. Thank you very much, Mr. Chairman.

Chairman SHELBY. Senator Sarbanes.

Senator SARBANES. Mr. Chairman, I know the Secretary I think is going to depart. Mr. Secretary, I have an issue not immediately related to the Rule under discussion today.

In late February, WBAL, one of our major television outlets in Baltimore, actually a Herst outlet, reported on a number of complaints about a mortgage-servicing company that appears to be mishandling the mortgage accounts of a number of its borrowers.

This has resulted in overcharges, insurance being forcibly added to certain mortgages at great cost to homeowners, and even in some cases, threats of foreclosure, which obviously sends people into a panic.

As you well know, Section 6 of RESPA sets out certain requirements for the servicing of mortgages. I would very much appreciate

it if HUD could investigate this matter and report to me or my staff regarding these problems. I will send you some information later in the day outlining the problem in greater detail, and I very much hope that you can pay attention to it. It seems to be a case of clear abuse and we are very anxious to get at it.

Secretary MARTINEZ. Senator, we look forward to your input on this. The Inspector General, I am happy to tell you, is investigating the situation already and we would look forward to any further input that you can provide us. But our Inspector General at HUD is already engaged in investigating what appears to be a horrible situation.

Senator SARBANES. Thank you very much, Mr. Secretary.

Thank you, Mr. Chairman.

Chairman SHELBY. Mr. Secretary, now, and I don't believe anybody's left here.

[Laughter.]

Secretary MARTINEZ. Thank you, Mr. Chairman.

Senator SARBANES. You are still standing, Mr. Secretary.

[Laughter.]

Secretary MARTINEZ. Somewhat standing.

[Laughter.]

Senator SARBANES. Still sitting, or whatever.

Chairman SHELBY. We welcome you here.

Secretary MARTINEZ. Mr. Chairman, thank you very much.

Chairman SHELBY. Let's work together on this.

Secretary MARTINEZ. We look forward to that. Thank you.

Chairman SHELBY. Thank you.

The hearing is adjourned.

[Whereupon, at 10:55 a.m., the hearing was adjourned.]

[Prepared statements, response to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF SENATOR JACK REED

Secretary Martinez should be commended for his efforts and leadership to streamline the homebuying process so Americans can shop for mortgages and can better understand what will happen at the closing table. If implemented correctly, the Proposed Rule reforming the Real Estate Settlement Procedures Act (RESPA) regulations could help achieve these worthy goals.

While I applaud HUD for undertaking this reform, I have a few concerns about the Proposed Rule to ensure that the goals of the reform and HUD's intentions are achieved.

First, yield spread premiums (YSP's), essentially the payments representing the difference between the underlying interest rate of the loan and the rate charged to the consumer, must go for closing costs and nothing else. Any other purpose should be classified as an illegal referral under RESPA law. According to a study by Freddie Mac and HUD's own analysis, 45 cents of every dollar of YSP does not go for closing costs, and that practice must stop.

Second, the Guaranteed Mortgage Package (GMP) as proposed by the reform should be limited to the prime market only. The exemptions provided by the Proposed Rule would make it too easy for subprime lenders to engage in predatory practices, which this Committee has been working very hard to prevent. There are relatively straightforward ways that HUD could ensure that GMP's are only offered in the prime market.

Finally, there has to be a stiffer penalty for the failure to follow rules, such as a private right of action, or originators will ignore the new rules when it is to their advantage to do so.

As a result, I hope that you will work to incorporate some of these changes into your Final Rule. If done appropriately, I believe your proposed reforms will help more Americans achieve the dream of homeownership. I am looking forward to your testimony today.

PREPARED STATEMENT OF SENATOR JIM BUNNING

Mr. Chairman, I would like to thank you for holding this very important hearing. I would like to thank Secretary Martinez for testifying today.

I do not think anyone here is not thinking about the military action in the Middle East. Many brave Americans have gone and or will soon go into harm's way. Our thoughts and our prayers are with those brave young men and women and with their families.

We must continue, however, with the work of the Senate, and we do have a very important issue before us today. I certainly applaud what Secretary Martinez has undertaken. Anyone who has recently bought a home knows how very complicated it is. At the end of the process, many homebuyers have no idea what they are signing. And many feel like they have "signed their lives away." Many times there are new last minute charges that require cash that suddenly appear. It is not always a fun process.

However, the housing market has been one of the very few bright spots in our economy. I understand the fear of having rules adversely affect that market. I think your charge on any change to RESPA should be: "First, do no harm." I know HUD has received many comments on this Proposed Rule. I know the Secretary has and will study them carefully.

Opponents of this Rule are making the case that this is a big guy vs. little guy fight. They are telling me the little guys cannot compete. I would like to hear the Secretary address that and also some other process questions, about the economic impact, for example, that have been raised. I know our colleagues in the House made the Secretary aware of some of these questions last week.

I also believe that some in the housing industry do not want any reform. The housing industry is vibrant and they do not want to fix what ain't broken. I can understand that. I also believe that it is in the best interest of some in the industry to keep the process as complicated as possible. That I cannot accept. We need to make it easier on the consumer to be able to purchase housing. We want more people in the market and we do not want them to feel intimidated. But we also must make sure that any solutions to the complications of RESPA are fair, and do not harm the industry. We really must try to minimize unintended consequences.

Once again, Mr. Chairman, I thank you for holding this important hearing. And thank you, Mr. Secretary, for testifying today.

PREPARED STATEMENT OF SENATOR ELIZABETH DOLE

Mr. Chairman, I would like to express my appreciation to you and to Ranking Member Sarbanes for agreeing to hold this hearing on the Rule proposed by HUD regarding the Real Estate Settlement Procedures Act (RESPA). This Proposed Rule seeks to make it easier for consumers to compare prices and get the best loan possible. Unfortunately, the current costs and complexities of the mortgage settlement process have created a barrier to homeownership for many Americans. Secretary Martinez and his staff should be applauded for their efforts to address these issues.

In recent years, the housing industry has supported and propped up our struggling economy. Mortgage rates are at an all-time low, the national homeownership rate is on the rise, and other countries look to our mortgage finance system as a model to be emulated. Naturally, changes to this process will raise questions from homebuyers and from businesses involved in the mortgage service industry.

Unfortunately, the mortgage settlement process is very complex, making it difficult to fully grasp the potential impact of this initiative. Some have stated that the Proposed Rule would create an imbalance on the playing field among mortgage originators, which could have unintended consequences for industry and consumers. That is not the intent of this Proposed Rule.

I believe each of my colleagues would agree that an effort to give homebuyers more options, to provide greater transparency, and to lower prices should be one of our highest priorities.

I certainly hope that this hearing allows all of us to gain a better understanding of how this new RESPA proposal will affect our housing and mortgage markets as we work together to ensure that more Americans are able to realize the dream of homeownership.

Thank you.

PREPARED STATEMENT OF MEL MARTINEZ

SECRETARY, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

MARCH 20, 2003

Chairman Shelby, Ranking Member Sarbanes, distinguished Members of the Committee, thank you for the opportunity to join you this morning to discuss the impact of a major initiative of the Bush Administration: Our unprecedented effort to better protect consumers and increase homeownership by making the home financing process more transparent, simpler, and less costly.

The emphasis Americans place on homeownership sets us apart from many other nations of the world. In this country, homeownership provides financial security for families and stability for children. It creates community stakeholders who have a vested interest in what happens in their neighborhoods. It generates economic strength that fuels the entire Nation.

The Bush Administration is very committed to helping more families achieve the American Dream of homeownership.

To do this, we must eliminate the homeownership gap that exists between the minority and nonminority populations. Last year, the President set a goal of creating 5.5 million new minority homeowners by the end of this decade, and he challenged the real estate and mortgage finance industries to work with us to boost homeownership among minorities.

Our partners have responded enthusiastically, by making specific commitments that will move us toward the President's goal. The Administration is doing its part by proposing a number of new and expanded homeownership initiatives in HUD's Fiscal Year 2004 Budget. Each initiative will help us break through the barriers that prevent too many Americans from knowing the security that comes with owning their own home.

The mortgage finance process and the costs of closing remain major impediments to homeownership. Every day, Americans enter into mortgage loans—the largest financial obligation most families will ever undertake—without the clear and useful information they receive with most any other major purchase. This makes them vulnerable to predatory lending practices.

After agreeing to the price of a house, too many families sit down at the settlement table and discover unexpected fees that can add hundreds, if not thousands, of dollars to the cost of their loan. As a result, many homebuyers find the settlement process to be filled with mystery and frustration.

This Administration is committed to streamlining the mortgage finance process, so consumers can shop for mortgages and better understand what will happen at

the closing table. For these reasons, HUD has proposed a major overhaul of the regulations governing the Real Estate Settlement Procedures Act (RESPA).

RESPA has been a priority of mine since I came to HUD. Shortly after taking office, I was faced with a major RESPA issue: The legality of yield spread premiums. Yield spread premiums are payments from lenders to mortgage brokers that are reflected in a higher interest rate. Since yield spread premium entails a higher interest rate, it can be unclear whether the higher rate results in the borrower being given a higher cost loan or whether it is being used to offset origination costs. In response, we issued a policy statement repeating our view that as long as the broker's compensation is for goods, facilities, or services, and the total compensation is reasonable, yield spread premiums to the mortgage broker are legal under RESPA.

At the same time, we recognized that there were serious disclosure problems involving yield spread premiums. We noted that less-scrupulous brokers often used yield spread premiums to generate additional profits, placing unsuspecting borrowers in higher-rate loans without their knowledge. And so in the process of issuing the policy statement, I committed HUD to establishing clearer disclosure rules for mortgage broker fees, and to simplifying and improving the mortgage origination process for everyone involved. There was general—virtually unanimous—agreement among all the industry groups, as well as consumer advocates, about the need for better disclosure: Simpler, clearer, and on a timely basis so consumers could shop for the best loan.

Beginning last year, we undertook a major reform of RESPA's regulatory requirements. And from day number one, we reached out to the affected industry groups to ensure their involvement.

As you know, the real estate settlement services industry is not a single industry but several that provide settlement services needed to help originate and to close mortgage loans. Settlement service providers include mortgage lenders, mortgage brokers, real estate professionals, title insurers, title and settlement agents, pest inspectors, appraisers, credit bureaus, and others. These businesses range from the very large to the very small, and include many sole proprietors. The combined efforts of settlement service businesses, large and small, have helped to make the mortgage finance system in this country the envy of the world.

At the start of our reform process, we met with industry groups, consumer advocates, and other interested parties to solicit their concerns about the RESPA regulations and their suggestions for reform. Many of their recommendations helped shape the direction of our proposal.

As we were drafting our reform proposal, we continued to meet with industry groups, consumer advocates, and other interested parties to ensure that, to the best of our ability, their concerns were addressed in our draft proposal. We were methodical and deliberative in our planning, and we took the time to get it right.

Nine months after first publicly announcing our intention to reform RESPA's regulatory requirements—and well over a year after our internal work had begun—HUD published its reform proposal for public comment. Within the Rule itself, we solicited additional input from the industry groups, consumer advocates, and other interested parties we had been communicating with throughout this process. The Rule asked 30 specific questions to help us gauge the impact of our proposal on these various stakeholders. We felt it was critical to know whether the approaches we have proposed are the right ones—and if not, what alternatives may work better.

HUD received nearly 43,000 public comments in response, although many of them were form letters. The 18 weeks since the comment period closed on October 28, 2002, have been spent carefully studying the written comments. Many have come from mortgage brokers and title agents. Also there were many detailed letters from trade associations for these industries. As you can imagine, reviewing and cataloguing the comments has been a lengthy process due to the sheer volume that we received.

These comments, along with the meetings that we have continued to hold since October with industry groups, consumer advocates, and other interested parties have been helpful in assisting the Department as we examine the impacts of the proposal on small businesses, and consider how best to minimize such impacts. All the while, we are keeping in mind that the goal of RESPA is to ensure that settlement costs for consumers are reduced.

Since the Proposed Rule was published last summer, alternatives have been brought to our attention. Our thinking is evolving on how portions of the proposal can be revised for the Final Rule, to ensure that all businesses, large and small, can take advantage of the opportunities presented by the Rule.

We remain committed to addressing the concerns raised by small businesses, and we are continuing to work with the Small Business Administration's Office of Advocacy as we develop the Final Rule. I want to assure the Committee that our Final

Rule, and the economic analysis to be issued with it, will address the concerns raised by the affected small businesses. The Department is committed to issuing a Final Rule fully mindful of impacts on small businesses.

Because they ensure greater transparency, our proposed reforms will make it more difficult for unscrupulous lenders to abuse borrowers. But let me be clear that RESPA reform alone will not end predatory lending. Efforts HUD has undertaken in the past 2 years to target abusive lending practices include at least 15 new rules focused on, among other priorities, weeding out unscrupulous appraisers, ending the practice of quick resales or "flipping," and helping us to identify problem loans and lenders early on. We intend to do even more to address predatory lending while preserving a source of credit for those with less-than-perfect credit histories.

HUD is committed to creating a homebuying and mortgage finance process grounded in transparency and simplicity. By reforming the rules governing the purchase and financing of a home, we will create new opportunities for first-time homebuyers, keep the American Dream of homeownership alive for more families, and inspire greater public confidence in the mortgage lending industry.

I would again like to thank the Committee for the opportunity to meet with all of you today. I welcome your continued counsel as we work together on behalf of the American people.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SARBANES FROM MEL MARTINEZ

Q.1.a. Both industry and consumer groups agree that YSP's are a necessary tool to allow people to take out low- or no-cost loans. In this case, a broker advances closing costs on behalf of the borrower, and then gets reimbursed through the YSP. According to this approach, YSP's should go to offset closing costs on a dollar-for-dollar basis. Indeed, Mr. John Courson, Chairman of the MBA, expressly stated at last year's hearing that YSP's should go to offset closing costs in full. Do you agree that a legitimate use of YSP's is to allow for low- or no-cost loans?

A.1.a. Yes.

Q.1.b. As you made clear in the hearing, you agree that, for a YSP to be legitimate, it must be fully used to offset the closing costs. In order for a borrower to know that the whole YSP is going toward closing costs, a borrower would need to know in advance what the broker is charging. Do you agree?

A.1.b. Yes, I agree. That is why we have proposed to modify the way loan originator compensation is reported to consumers.

Q.2. If brokers disclose their costs, wouldn't we expect consumers to start shopping for brokers based on their price? Wouldn't competition among brokers be a good thing for consumers? If you do not know a broker's price, you could not shop, is that correct?

A.2. Many brokers do disclose all their compensation to their customers. Others reveal the fees they are charging the consumer directly, but do not adequately explain any YSP they may be receiving. We believe complete disclosure of all broker compensation, both direct and indirect, early in the process, will better inform consumers of the impact of any YSP, and will empower consumers to shop and make more informed decisions.

Q.3. Some legitimate concerns about competitive equity have been raised regarding the issue of disclosure of broker compensation. The argument is that the Proposed Rule requires the brokers to reveal their compensation, but it does not require lenders to reveal their compensation. In some regards, this is academic, because it is my understanding that brokers have agreed to full and upfront disclosure. Furthermore, we have seen that it is absolutely necessary to disclose broker compensation in order to ensure that YSP's are fully used to offset costs. Nonetheless, does the Proposed Rule allow borrowers to fairly compare the costs of a lender-originated loan with a broker-originated loan?

A.3. That certainly was our purpose and intention in the Proposed Rule. We received a number of comments raising questions about the proposed GFE. Based on those comments, and on consumer testing conducted in conjunction with the Federal Trade Commission, we are revising the proposed GFE rules and form, and we believe the Final Rule will ensure a more level playing field for all originators while further enhancing the consumer's ability to compare products and providers.

Q.4. How do you respond to the concern that large companies, particularly large lenders, will have an advantage in creating these

Guaranteed Mortgage Packages (GMP's)? Specifically, will these large companies be able to force smaller settlement service providers or even title companies to drop prices so much they will be put out of business?

A.4. First, I do not subscribe to the idea that "packaging" will result in a greater concentration of market power in large lenders. Our proposal opens the door to anyone to become a "packager," and I believe a wide variety of players will ultimately emerge. Packaging is not required. It is optional and smaller providers may compete as packagers or as independent providers. Moreover, mortgage origination is, by its nature, a local process—all transactions require specific settlement services that are performed locally, such as appraisal, property inspection, title search and the like, and it is entirely conceivable that these settlement service providers, working with smaller lenders, may, either independently or cooperatively, offer their own packages. Mortgage brokers, and realtors, who are familiar with the local service providers in their area, may do the same.

Q.5. Another criticism I have heard is that the GMP may, in the short run save consumers money as all the independent service providers are forced by large lenders to lower their prices to get into a package. However, there is no guarantee that the larger institutions will pass those savings on to consumers. How do you respond to that?

A.5. We believe that packaging will force competing packagers to innovate to lower the costs of their packages and that simple, easy to understand, firm, and binding offers will empower consumers to shop effectively, and that this will lower costs further and drive the marketplace. It is true that there is nothing in the GMP proposal requiring "packagers" to pass along to consumers any of the savings realized when packagers and third-party settlement service providers negotiate discounted prices. But there will be many packagers competing with each other, and therefore no such requirement is needed, because competition will squeeze out excesses in the pricing of packaged mortgage loans.

Q.6. Some even argue that, in the long run, large institutions, using their economic leverage, will undersell smaller institutions, brokerage firms, and others, driving them out of the mortgage business. Then, having eliminated the competition, they will raise their prices to consumers. Again, how do you respond?

A.6. As I noted earlier, it is particularly hard for me to envision a mortgage world in which smaller, local entities are not active participants. It is worth noting here that one of the reasons mortgage brokers have become such a large component of the industry is that large wholesale lenders have found it more efficient to a greater or lesser extent to utilize brokers than to maintain their own retail outlets. If large lenders drive smaller loan originators and settlement service providers out of business, they will have to establish their own network of local actors to replace them. That is a cost they are not likely to incur.

Q.7. As I mentioned, one of my concerns with the Proposed Rule is that it does not allow for sufficient enforcement. Let me discuss

this in the context of the GMP. Assume a lender guarantees a borrower a 30-year mortgage at 6 percent with $2,000 in closing costs. Yet, at the closing table, the borrower is charged $3,000. He can refuse to close the loan, but he may lose the house he is buying. It is likely that a consumer will go ahead and sign the loan.

In this case, the Proposed Rule says that the borrower has a remedy in contract law, and that the lender would lose the Section 8 protection that came along with the package. This has 2 problems. First, there is no practical way to enforce the contract. No attorney will take a case where the damage is only $1,000.

Second, *this approach puts the burden on the consumer,* who has been cheated, to prove his case. In fact, a consumer would not be able to prove the case because he or she will not have access to specific settlement costs, so they will not be able to pursue a Section 8 claim. How could a consumer realistically be able to pursue a claim and enforce the law unless the Rule puts the burden on the originator who failed to live up to the guarantee to prove that there is no Section 8 violation?

A.7. We are seeking through this rulemaking to provide as much protection for consumers as is possible under current law. In that vein, as we develop a Final Rule, we will be considering comments on our proposed remedies to enhance consumer protection under the law. As I have previously said, we will then turn to the question of whether additional legal authority in the enforcement area is likely to be needed to complement these new rules.

Q.8. I am also concerned that the YSP provisions in the Rule do not allow for any enforcement. As you know, the YSP provisions are in the GFE section, which has no enforcement mechanism or penalties. Prior to the 2001 "clarification," consumers could enforce the prohibition against the use of YSP's as illegal referral fees through Section 8 of RESPA. The 2001 policy "clarification" cited the "ambiguity" of the treatment of YSP's in eliminating the ability to pursue class actions.

The new proposal under consideration eliminates this ambiguity and would fairly allow for the enforcement of the YSP provisions through Section 8, the mechanism that was used prior to the 2001 "clarification." Why not restore this enforcement mechanism by putting the section of the regulation dealing with the YSP's in the part of the Code of Federal Regulations dealing with Section 8 of the law?

A.8. The Proposed Rule's treatment of YSP's is located in the GFE disclosure section of the Rule because what is proposed is a change in the means by which a particular aspect of a transaction is disclosed. We are examining the comment that a failure to disclose should be explicitly treated as a Section 8 violation in the Final Rule, along with other comments from the consumer advocates and also industry groups regarding appropriate penalties for failure to properly disclose.

Q.9. It has come to my attention that some HUD-certified housing counselors are having difficulty supporting their excellent work promoting homeownership because certain lenders are concerned that the payment of a fee to a certified counselor in exchange for *bona fide* counseling services might violate RESPA. I have heard

this concern specifically from the National Council of La Raza Network Housing Counseling Network. Some La Raza affiliates offer, or would like to offer, these services for a very modest flat fee. Do you agree that RESPA allows payments from lenders or other settlement service providers to housing counselors in exchange for *bona fide* counseling services?

A.9. Yes. RESPA always permits payments for *bona fide* services rendered. It prohibits kickbacks, payments for the referral of, splits of fees, and unearned fees in connection with the settlement service business.

United States Senate
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510–6075

December 19, 2002

The Honorable Mel Martinez
Secretary
Department of Housing and Urban Development
451 7th Street, S.W.
Washington, D.C. 20410

Dear Mr. Secretary,

We appreciate the opportunity to comment on the Department of Housing and Urban Development's (HUD) proposed changes to the regulations governing the Real Estate Settlement Procedures Act (RESPA). The proposal is extremely complex and potentially wide-ranging, both in its own right, and with regards to the impact changes to RESPA rules may have on currently existing and crucial consumer protections provided by other laws. HUD has an opportunity to act in a way that maintains the important protections contained in the Truth in Lending Act (TILA) and improve the real outcome for mortgage borrowers.

Broadly speaking, the proposal includes two basic parts: important improvements to the current mortgage delivery system dealing with the Good Faith Estimate (GFE) and compensation for mortgage brokers through yield spread premiums; and, the "Guaranteed Mortgage Package" (GMP) which would likely result in significant changes to the way in which mortgages are currently offered. This letter addresses a number of key issues in each of these areas.

I. The Good Faith Estimate

Both the proposed rule and the 1998 "Joint Report to the Congress" by HUD and the Federal Reserve Board (Fed) make it clear that the current system fails to adequately serve the needs of consumers. Specifically, the current system provides the consumer with information that is simply too uncertain, too expensive, and/or too late in the process to allow them to shop for a mortgage effectively. Indeed, all too often, the current GFE has become a tool to lure borrowers, particularly subprime borrowers, to the closing table, at which time many discover the final costs significantly exceed those on the GFE. Unfortunately, many of these borrowers find themselves in a "take-it-or-leave-it" situation and must proceed with the loan despite the unexpected costs.

For these reasons, we support HUD's proposal to make the GFE more accurate. In particular, the proposal to require origination charges to be fully, precisely, and accurately disclosed in the GFE is both reasonable and fair. Lenders and other originators should know their fees at the time they provide a GFE. The tolerance for these charges should be no more than 10 percent, as suggested by HUD.

In order to make these provisions effective in the marketplace, HUD should amend its proposal to state that any charge beyond the tolerances permitted by the new regulation be considered an unfair and deceptive practice. This will create an enforcement mechanism for borrowers who are victimized by originators who do not live up to their GFE commitments. Without this change, too many lenders will be tempted, once again, to use the GFE as a tool to bait and switch borrowers because they are unlikely to pay any penalty for failing to comply with the new rule.

We also strongly support the requirement for mortgage brokers to disclose their total compensation in the form of a binding agreement with the consumer. It is common sense that a consumer should be told of the price of the service being offered prior to buying that service. American homebuyers should have the option of shopping for their mortgage broker on the basis of the broker's charges in the same way they shop for any other service.

We further support the proposal that any yield spread premiums paid by the lender go directly to the borrower. This should appear as a cash credit to the borrower so as to ensure that it is treated consistently in all transactions. As you know, the Senate Committee on Banking, Housing, and Urban Affairs held a hearing on yield spread premiums (YSPs) earlier this year. The hearing showed that many consumers are, without their knowledge, steered to higher cost loans by brokers who receive YSPs from lenders in return for closing the higher rate loans. Moreover, most consumers never know that the broker receive this compensation. The industry has justified this practice by saying that YSPs make no or low closing cost loans possible because these lender payments offset such costs. However, studies provided to the Committee at the hearing, as well as further research conducted by Freddie Mac, shows that the bulk of these YSPs go to increase the compensation of the brokers rather than offset closing costs associated with the loan. Indeed, the Committee was provided with testimony that indicates that lenders pay YSPs as a way to attract business from brokers, without regard to any services rendered or facilities provided. In such cases, YSPs are simply payments for the referral of business, which violate section 8 of RESPA.

Requiring that YSPs go to the borrower would prevent mortgage brokers, as the proposal points out, from:

> ... increas[ing] their compensation without the borrower's knowledge, by placing the borrower in an above par [higher cost] loan and receiving a payment from the lender (yield spread premiums)....

Instead, the new rule would ensure that "maximum mortgage broker compensation will be clear and brokers will have no incentive to seek out lenders paying the largest yield spread," as the proposal states. Under this regime, if properly instituted and with sufficient enforcement, the interests of the broker will be aligned with the interests of the borrower "to find the best loan product [the broker] can for the borrower," as the rule says.

To ensure that you get this desirable outcome, it is not enough to require that brokers commit to a maximum level of compensation, and that YSPs be credited to the borrowers. HUD should go further and make sure that these provisions are fully and effectively enforceable. A number of steps must be taken to achieve this goal.

A. The provisions dealing with YSPs should be put in the regulations prohibiting kickbacks and unearned fees (24 CFR 3500.14). It is clear from the testimony presented at our hearing, and from legal actions and other studies, that many YSPs currently paid by lenders are illegal referral fees. As the proposed rule recognizes, the current system creates incentives for mortgage brokers to "seek out lenders paying the largest yield spread;" in other words, to refer business to those lenders who offer the greatest payments for those referrals. Because this is a violation of section 8, the regulations governing these payments properly belong in section 24CFR 3500.14.

B. In addition, to make the YSP and GFE proposals effective, the rule should be amended to allow for private enforcement, including the use of class actions. HUD, particularly given tight budgets, will not be able to enforce many of the provisions of this rule by itself. It was asserted that HUD's October, 2001 policy "clarification" on the issue of YSPs, which undermined the ability of consumers to seek redress for being steered into higher rate loans, was premised on the concern that existing rules under RESPA were not clear. However, once this new proposal is implemented, all lenders, brokers, and other market participants will know the rules. HUD should not undercut courts who may agree that violations by particular companies are subject to class actions.

We have a number of other suggestions on the proposed GFE changes. The proposed language regarding the broker relationship to the borrower is likely to be confusing and does not promote a better or more efficient mortgage origination process. In addition, we have repeatedly seen that mortgage brokers market themselves as representatives of the borrower, notwithstanding simultaneous claims that brokers are independent. For example, materials printed by the National Association of Mortgage Brokers (NAMB) describes the mortgage broker as "an expert mentor," (i.e. trusted advisor) to guide the consumer "through the complex mortgage origination process." Finally, it is our understanding that, under a number of state laws, brokers do have an agency relationship with the borrower. HUD should not interfere with these or other state laws dealing with the mortgage process. Finally, the comparison chart on the GFE form should include the actual terms that are being offered to the borrower.

II. The Guaranteed Mortgage Package

The Guaranteed Mortgage Package (GMP), *if implemented correctly*, has the potential to reduce costs through enhanced competition where markets function effectively. However, HUD must be certain that the use of the GMP does not facilitate predatory lending by eliminating existing substantive protections under the Truth in Lending Act (TILA), particularly for subprime borrowers. Much of the proposed rule under discussion seems to be based on the1998, HUD/Fed Report on the reform of RESPA and TILA. One key element of the Report was the finding that RESPA and TILA reform should take place simultaneously with new legislation that provides substantive protections against predatory lending. While a rulemaking alone cannnot create new statutory protections, HUD should do everything possible to avoid undermining the important and substantive protections noted in the HUD/Fed Report that are currently provided by TILA. Any other course of action would, in effect, put HUD in the position of creating a safe harbor for unscrupulous, predatory lenders who prey disproportionately on minorities, immigrants, the elderly, and low income homeowners.

To make sure the GMP works in a constructive manner, we recommend the rule adopt the following changes:

A. The GMP should be limited to the prime market only. The evidence is clear that predatory lending is largely a function of the subprime market. As stated above, applying the package to the subprime market will undermine current consumer protections without replacing them with any alternatives. This is because the package would eliminate the need to list specific fees for different goods and services, which are needed to enforce TILA. Losing the ability to enforce TILA will result in real harm to those borrowers who are already the most vulnerable. HUD should not put itself in a position of creating more opportunities for unscrupulous mortgage lenders, brokers, and others to take advantage of minorities, the elderly, and working Americans who borrow in the subprime market.

Extensive testimony taken at the recent Senate hearings, a 1998 hearing held by the Senate Aging Committee, and hearings held in both the House and Senate prior to the passage of the Home Owners and Equity Protection Act (HOEPA) in 1994 show there are major deficiencies in the functioning of the subprime market. The recent settlements of the Federal Trade Commission and the Attorneys General of several states with two of the largest subprime lenders in the nation document the kind of practices in which even the largest, most visible subprime lenders engage. Affidavits by employees of these large companies further attest to the effort many subprime lenders put into targeting and then taking advantage of subprime borrowers, pushing them deeper into debt and stripping their hard-earned home equity. Taken as a whole, this evidence clearly indicates that one of the key characteristics of this market is that lenders shop for borrowers rather than the other way around. The GMP will not resolve this basic problem. These lenders will simply build their higher costs into the package.

HUD can avoid making the GMP apply to the subprime market by prohibiting the use of the package for all HOEPA loans, loans with prepayment penalties, and loans with a guaranteed mortgage price of 5% of the principal of the loan or higher. These are overwhelmingly characteristics of subprime and predatory loans.

On the other hand, the GMP can work effectively in the prime market. At least one very large lender is already offering a guaranteed interest rate and closing cost package. Given the technology available in today's marketplace, the GMP should be able to be offered shortly after the rule is finalized.

B. The GMP should include, as HUD proposes, both a guarantee on a mortgage rate and closing costs. The guaranteed interest rate can be subject to the fluctuations of the marketplace, as the rule suggests. That guarantee can be tied to a particular loan product which the consumer has been offered through the GMP, so long as the consumer can monitor that rate on an ongoing basis.

The guaranteed price must be subject only to the confirmation of information requested by the packager. The rule in no way limits the amount of information the lender may request prior to making the offer. This should adequately protect lenders and packagers. The offer must be firm if the consumer is going to use it as a tool to shop, as HUD intends. The proposed rule is ambiguous on this point. We urge HUD to clarify that only material differences in information provided by the consumers may be grounds for revoking the GMP offer.

C. HUD should confer with the Federal Reserve Board to make sure that closing costs within the package are treated in a uniform manner for TILA purposes. The key advance that the GMP would represent would be that consumers would get one or two easily understandable prices with which they can comparison shop. One such price is the annual percentage rate (APR). However, the calculation of the APR can change depending on how certain closing costs are characterized. That means that the exact same loan – same principal, same interest rate, same term, same closing costs – may actually have different APRs depending on how certain closing costs are listed for TILA purposes. This could result in lenders "gaming" the APR to mislead consumers, thereby undermining the very purpose of the GMP and limiting consumers' ability to seek relief for possible TILA violations. HUD should work with the Fed, prior to releasing the final rule, to make sure packagers treat these costs in a consistent manner.

D. The GMP must be *effectively* enforceable by consumers. The current proposal does not provide any adequate enforcement by consumers for packagers who do not live up to their GMP commitments. As with the GFE, there has to be some penalty for failure to follow the rules, or originators will ignore those rules when it is to their advantage to do so. The main benefit of the GMP option to the originator or packager is the exemption from section 8 anti-kickback provisions. Simply removing this exemption upon failure to honor the GMP is not adequate, especially because the nature of the package means that consumers will not have the detailed information on payments among settlement service providers necessary to show a

section 8 violation. The best way to ensure that adequate enforcement will take place is to make it clear in the final rule that the failure to honor a GMP offer creates the presumption of a RESPA section 8 violation that can be privately enforced, including through class action litigation.

Thank you for your consideration of our views.

Sincerely,

Paul S. Sarbanes

Christopher Dodd

Jack Reed

Charles Schumer

Debbie Stabenow

Jon Corzine

Daniel Akaka

THE IMPACT OF THE PROPOSED RESPA RULE ON SMALL BUSINESSES AND CONSUMERS

TUESDAY, APRIL 8, 2003

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:05 a.m. in room SD–538 of the Dirksen Senate Office Building, Senator Richard C. Shelby (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The hearing will come to order.

I want to thank the panel for assembling today before the Senate Banking Committee for the second in a series of hearings on HUD's Proposed Rule to the Real Estate Settlement Procedures Act.

On March 20, the Committee heard from Mel Martinez, Secretary of the Department of Housing and Urban Development, on HUD's goal of reforming the real estate industry through this rulemaking. At that time, I, and several other Members of the Committee expressed our agreement that the underlying goals behind HUD's effort are laudable. Simplifying the complex paperwork surrounding homebuying has the potential to improve homeownership rates, eliminate unwelcome surprises from occurring at the settlement table, and increase competition within the industry. There is no debate on whether these are worthy goals.

Substantial debate, however, has centered around whether this Proposed Rule would accomplish those goals. Concerned parties from across the Nation, and even internally in the Federal Government, have let HUD know of their concerns. During the public comment period, and even after, a barrage of objections were released. HUD received in excess of 40,000 comment letters. Three committees or subcommittees on the House side have received testimony on this controversial proposal. This Committee met just last month about the Proposed Rule to hear from the Administration and is again gathering to hear from consumer groups and industry groups about the impact this Proposed Rule would have on the central players in the $2 trillion real estate market. Additionally, we have received more mail on this issue at the Committee than on any other topic that I can recall.

My views on the Proposed Rule are widely known. In its current form, I think it is anti-competitive, significantly damaging to small businesses, and lacks effective provisions to provide clarifications for consumers. While I feel there could be an emerging place for packaging in the current real estate environment, I have signifi-

cant concerns that HUD's proposal allows packagers an exemption from disclosing fees. And I have not been able to get a satisfactory answer from anyone that explains why hiding information from consumers protects them. In my experience, the best decisions are made when consumers are armed with all the information they need to make an informed choice. Transparency, I believe, is a central component.

Regarding competition, I feel like this Rule accomplishes the opposite of what is intended. The underlying principle of guaranteed mortgage packaging is that savings achieved through volume discounts with settlement service providers will be passed on to the consumer, resulting in lower settlement costs. But what evidence is there to demonstrate that those savings would be passed on?

It is my fear that only large institutions would have the market power and volume of business to compete in that environment. The result could be that small businesses, who lack the resources of large lenders, could be shut out of the process and only large lending institutions would prevail. Ultimately, competition would be stifled, rather than enhanced, as the large players increase their market share and push small firms out of business. What incentive would exist then to pass on savings to the consumer?

Finally, the recharacterization of yield spread premiums as a lender payment to the borrower is a misleading one that will limit the broker's ability to compete on a level playing field with lenders. It would not, in fact, lend "clarity" to the process. And this sentiment is just not my own. The Federal Trade Commission actually said that this change could, "Confuse consumers and lead them to misinterpret the overall cost of a transaction."

For these reasons and others that will likely be articulated here this morning, I asked Secretary Martinez to reconsider this proposal and address these concerns. At our March hearing, I asked that the Secretary commit to issuing both a new, more thorough, and expansive Economic Analysis and revised Proposed Rule that takes into consideration the results of the new Economic Analysis. I have hopes that he will do just that. I have conveyed the message that I firmly believe that it can only lend credibility to the process and win him points for being conscientious and fair.

Having said this, let's hear opening statements and then move on to the first panel.

Senator Sarbanes.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Mr. Chairman, I want to commend you for holding this hearing. I think it is very helpful, particularly with issues as complicated as RESPA, to have witnesses representing different points of view coming before us, and I anticipate considerable give and take from the panel that is going to follow Congressman Manzullo. Hopefully, that discourse will help us to shed some additional light on this important issue.

The Real Estate Settlement Procedures Act helped to bring some order and equity to a process that was suffering from rampant kickbacks and referral fees among settlement service providers at the expense of the consumers, and we need, of course, to recall that

history that has led to the enactment of the legislation in the first place.

RESPA has sought to align market incentives with the interests of borrowers and it has had some success in doing so. But RESPA needs to be updated, however, the goals should continue to be the same—the creation of a mortgage market that effectively serves consumers' interests.

HUD is working on a proposal that it hopes will achieve this goal. In my view, if done correctly, the Proposed Rule holds out the prospect of resulting in significant good. However, if not done correctly, I think it could result in significant harm. So, we have an important issue before us. Or HUD, more accurately put, has an important issue before us.

A number of us on this Committee sent a letter to Secretary Martinez outlining what we think should be essential elements of a Final Rule. And I would like to just touch on a few of those key principles.

First, the Rule most not undermine existing RESPA or Truth in Lending Act protections for subprime borrowers. Subprime borrowers are far more likely to be subjected to predatory practices against which both RESPA and TILA provide some remedies. We must be sure the Final Rule retains these important protections.

Second, the additional protections that the Proposed Rule would create are of little use if they are not enforceable. Regrettably, the Department's 2001 policy "clarification," undermine the ability of consumers to seek redress against illegal yield spread premiums, half of which, as HUD's analysis points out, are not used to offset closing costs, which, of course, was the industry assertion as to why these things were appropriate. The proposed changes in the treatment of yield spread premiums, as well as the Guaranteed Mortgage Package, if we proceed on that front, must allow for effective enforcement, which includes private enforcement.

Third, a Final Rule must not allow bait and switch tactics. The Guaranteed Mortgage Package should include an interest rate and should be contingent only on the confirmation of information provided by the borrower. If done in this way and if limited to the prime market, the package has the potential of improving outcomes for consumers.

Finally, the Rules should not preempt State laws. For example, a number of States have laws that require brokers to act as agents for the borrower. HUD should not undermine those laws.

Of late, there has been a lot of discussion in the press of efforts by HUD to find a compromise or to work out a proposal that would command a broader consensus. It seems to me, at the very least, the Department needs to move ahead with a proposal, and I now quote the Department from its written testimony to the Congress earlier in the year: "To ensure that yield spread premiums are fully disclosed to consumers, that consumers determine whether and how to use them, and that consumers receive the full benefit of any such payment."

If the consumer is going to be led into a higher interest rate, then the consumer should receive the benefit of that rate and it ought not to go to the person leading them to the higher rate.

One thing that was made abundantly clear about yield spread premiums last year is that it is minority homebuyers that bear a disproportionate burden under the current system.

In a letter to Secretary Mel Martinez, the National Council of LaRaza, the NAACP, and the National Hispanic Housing Council wrote: "That the abuse of yield spread premiums, rather than promoting minority homeownership, is disproportionately making it harder for Americans of color to buy their own homes."

The whole rationale by which the consumer is led into a higher interest rate is to offset closing costs. Now if the borrower is not fully aware of the fact that he has paid a higher rate, he cannot exercise that option. Instead of the amount going to offset the closing costs, those amounts go to the person who led them into the higher interest rate.

Stop and think about that for just a moment. It is clearly an anti-consumer practice, and in my view, my strongly held view, the Final Rules should prevent this from happening.

Mr. Chairman, I look forward to hearing Congressman Manzullo, and then, subsequently, the panel.

Chairman SHELBY. Senator Crapo.

COMMENTS OF SENATOR MIKE CRAPO

Senator CRAPO. Thank you very much, Mr. Chairman. In the interest of time, I won't make a long statement.

I do want to say that I share the concerns that you have raised and hope that message is getting through. I believe that what we will hear today are a series of concerns that need to be heard, and as you said, a reminder that the goals of this Rule, and of the legislation underlying it, are very worthwhile and laudable, which we should be working expeditiously to achieve.

I hope that we can move forward with these oversight hearings to help the Agency understand the reforms that need to be made in its approach to the management of the issues.

I also want to welcome my good friend and colleague—our good friend and colleague—Representative Don Manzullo. Don and I were elected to the House at the same time, and we worked on a lot of issues over there together, and still work on a lot of issues together. He is one of my good friends over in the House. In fact, when I need my batteries recharged, I go back over there to the House to talk with some of those guys and get a little bit of that fiery spirit back again.

So, I appreciate you being here with us today also, Mr. Manzullo.

Mr. Chairman, I thank you for holding this hearing.

Chairman SHELBY. Thank you.

Senator Stabenow, do you have an opening statement?

COMMENTS OF SENATOR DEBBIE STABENOW

Senator STABENOW. Thank you, Mr. Chairman, very much for holding this hearing. And welcome to my former colleague as well.

Like Senator Crapo, I enjoy going back to the House and visiting with friends and I appreciate your advocacy on behalf of small business and your efforts in the House.

Also, I want to thank Chairman Shelby for holding this second hearing on a very important topic—the Real Estate Settlement Pro-

cedures Act. I have joined with colleagues for some time in indicating that consumers need more certainty and more transparency in homebuying.

I hear that at home all the time, concerns about the issues that are raised. And any sound and balanced effort that accomplishes these goals is one that I want to lend my support to.

Buying a home is the single most complicated financial transaction that most Americans will ever undertake, and probably the most important, since the majority of Americans save through the equity in their home, and that is a very important investment. It can be very confusing and consumers often have a difficult time shopping for different loan products. Even people who consider themselves relatively financially savvy can get bogged down in the process.

So, I think it is important that we are looking at these reforms. And I am anxious to hear what our witnesses have to say about the Good Faith Estimates and what they feel about that process, as well as the additional processes that relate to the loan packages.

I appreciate the Chairman having this hearing. I will submit my full statement for the record and ask that it be included.

Chairman SHELBY. Without objection, it will be included.

Senator STABENOW. Thank you.

Chairman SHELBY. We are pleased to have with us this morning, Congressman Donald Manzullo, Chairman of the House Small Business Committee. His Committee, as he will likely elaborate on, held a hearing in March on the impact of the RESPA Rule on small business providers. He will be our first witness.

The second panel is comprised of industry and consumer groups, which I will introduce individually once we move to that panel.

Your prepared statement, Congressman, will be made part of the record in its entirety. We welcome you to the Senate. You have a lot of friends over here. We respect the position you hold in the House as far as small business and your interest in this issue. You proceed as you wish.

STATEMENT OF DONALD A. MANZULLO A U.S. REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS CHAIRMAN, HOUSE COMMITTEE ON SMALL BUSINESS

Representative MANZULLO. Thank you, Chairman Shelby, Ranking Member Sarbanes, and the Members of the Committee for the invitation to testify on the effects on the small business community and on consumers of the Department of Housing and Urban Development's proposal to revise the regulations implemented in RESPA. I come before you today not just as the Chairman of the House Small Business Committee, but also as a Member of the House Financial Services Committee. In addition, prior to being elected to the Congress, I was an attorney in private practice for over 22 years and I personally closed more than a thousand real estate transactions. Those transactions were commercial, residential, and farms. Also, I represented banks, I represented the FDIC, and I mopped up when a bank failed. I have represented real estate firms, title companies, and an array of people that are involved in title real estate closings.

I agree with the opening statements of all four Senators. They are not inconsistent. And there is a way to use the system in order to protect consumers. But let me frame the question this way. It is a tough question, but I am going to frame it this way. Why has HUD taken a position that legitimizes kickbacks to large lenders that enter into agreements with settlement service providers and allows those relationships to be hidden from consumers while at the same time proposes to more fully disclose other transactions to consumers? That is the issue.

Senator Sarbanes mentioned the word kickbacks. I do not like that word because that means a payment that does not have to be disclosed. And that is exactly what could be done for the ones involved that guarantee the package, that guarantee the interest rate lock, that can enter into different transactions.

The proposal should focus on better disclosure of the various settlement fees so that consumers are fully advised of all fees going into a settlement transaction rather than permitting large mortgage lenders to hide their fees charged to consumers and the monies received from settlement providers.

Everybody is in favor of disclosures. But the disclosures should be fair. The same thing that a mortgage lender has to disclose should be exactly what a mortgage broker has to disclose. Same rules, same transparency.

I fully support simplifying and clarifying the settlement process so that first-time borrowers and homebuyers can enter the market. I believe that HUD's RESPA proposal will make fundamental, and most likely, irreversible changes to our residential real estate market. In the short-term, the proposal may jeopardize a robust real estate market. In the long-term, the proposed changes may undermine the goals of providing affordable housing and enhance protections for consumers. This proposal is bad for small businesses and it is bad for consumers.

On March 11, I chaired a hearing of the House Small Business Committee to hear testimony from Secretary Mel Martinez and the small business community on the impact of the proposal on small entities. This was a bipartisan effort with Members of both sides of the aisle expressing strong concerns about the proposal, including Ranking Member Nydia Velazquez. She is also a Member of the Financial Services Committee and she wrote a comment letter directly to HUD about her concerns.

In addition, there are bipartisan Members of the House Financial Services who share our concerns. Congressman Mel Watt of North Carolina is a Democratic Member of the Financial Services Committee. We have very similar backgrounds and we were elected to Congress the same year. He and I have the same view of the RESPA proposal and believe that it would significantly harm our real estate market, consumers, and small businesses. The two of us circulated a Dear Colleague letter to HUD to simply deep-six this proposal and start it all over again.

While the small business community has many concerns about HUD's RESPA proposal, the two primary concerns are that the proposal is tilted unfairly toward the mortgage lending community and against small business real estate professionals, and HUD did not fulfill its obligations pursuant to the Regulatory Flexibility Act.

The Small Business Committee has a lot of jurisdiction over the Regulatory Flexibility Act and SBREFA, which allows for judicial review of that.

The overwhelming majority of the small business community that have contacted the Committee, including virtually all the small settlement providers and a significant portion of the community banks, believes the proposal would unfairly give significant power to the mortgage lending community, especially large lenders, to put together Guaranteed Mortgage Packages. Small businesses that are unable to participate in the package arrangements must attempt to compete using the detailed itemized listings under the proposed Good Faith Estimate reforms. Those small businesses also would be ineligible for safe harbor relief.

A significant fear is that large mortgage lenders may use the package of settlement services as a "loss leader" in order to obtain the more lucrative servicing and secondary market fees associated with the administration of a residential real estate loan. Once competition in the marketplace is reduced, the packagers may attempt to bulk the price of other products, services, and items with the purchase of a home.

With regard to its economic analysis conducted pursuant to the Regulatory Flexibility Act and Executive Order 12866, HUD acknowledged that the proposal would place a $9.4 billion burden on small businesses. Of this $9.4 billion, $3.5 billion comes from the revised Good Faith Estimate proposal and $5.9 billion comes from the packaging initiative. However, HUD does not break down the costs in its economic analysis for each segment of the industry.

Of the 98 pages in HUD's failed attempt, their unscholarly attempt, to comply with the law that protects the consumers, small businesses, and entities affected, only 64 pages deal with the economic analysis. That comes out to $147 million per page.

In the hearing that we held on March 11 in my Committee, I asked Assistant Secretary Weicher, where in this report do you mention the role that attorneys which our small businesses have in real estate closings?

His reply to me was, well, we have identified here the bigger impact—the big impact. And that led to a very interesting colloquy where I said, "You cannot pick and choose which businesses you are going to do research on."

The analysis of HUD is fundamentally flawed because it must, by statute—must, must—reach out to every single business affected and do an economic impact on exactly what will happen to those businesses should the regulation go into effect. HUD has failed to do so.

I asked HUD to issue a revised economic impact. They refused to do that. What I get from HUD is, well, when we issue the Final Rule, then we will give you the final economic impact. And at that point, it is too late. It is just too late.

There is no room in this Government for lack of scholarship. HUD simply has lots of people there. They have economists, they have lawyers, and they have accountants, people that can do a very thorough economic analysis.

On page 45 of their report, two sentences talk about the role of lawyers in real estate closings. The question Dr. Weicher asked me

was, what did you charge for a real estate closing? I said $100 to $300. His comment was, we only focus on the big issues.

Well, excuse me. But small-town lawyers, title companies, people who draw deeds, people who are involved in pest control, mortgage brokers, appraisers, surveyors—these are all people. They are not just names of professions. These are people who know what they are doing and understand this subject.

The bigger problem in what we will see is this. If this goes through, you are going to see ads coming out from one of the 13 big companies that say, "You trusted us in the past. Trust us now. Before you buy or sell your house, this is a one-stop-shop. You call 1–800–BIG–BOYS and we will do all the work for you. All you have to do is show up at closing. We will take care of all of the details for you."

They sure will because Section 8 is waived that allows a kickback. They can go in there. The bundlers. They can go in there and they can enter into an agreement with the title company and have a secret, undisclosed agreement to get a kickback for an undisclosed fee. But they will do more than that because they will use their power to put together this package and to determine and fix in the interest rate.

By the way, nobody except the mortgage lenders can lock in the interest rate. The surveyors cannot do it. The attorneys cannot do it. The title companies cannot do it. It is the ones that control the money, and those are the large lenders.

And what will happen, Senators, is you will have a situation where they will say, we will take care of everything for you. Oh, by the way, we would suggest that your house is 20 years old and it has single-pane windows. We can put you in contact, yes, with a window company and nothing would have to be disclosed there as to that cozy arrangement. By the way, we can clean your carpets, clean your gutters, put on that new roof. And you know what? You work very hard. Maybe you should borrow an extra $5,000 and you can put in new rugs and new flooring.

I see this thing as nothing but a monster, and we do not need it because the system is not broken.

If the Senate and the House want to do something for small businesses and for consumers, separate the disclosure end from the bundling end. Concentrate on the disclosure. Let's work on that and make sure that whoever is involved in that real estate transaction knows exactly what he or she is paying.

Thank you for your testimony—for my testimony.

[Laughter.]

That is what happens when you are a Chairman, right?

[Laughter.]

Well, that is my testimony. Thank you for listening.

Chairman SHELBY. Congressman, we appreciate you coming today and sharing this with us. You are the Chairman of the Small Business Committee. So, I want to ask you a question. As the Chairman of the Small Business Committee in the U.S. House of Representatives are you aware of any nonlender, small business trade group that supports HUD's RESPA proposal?

Representative MANZULLO. I do not know of any. In fact, a lot of the small-town banks are terrified because they would get smoked.

Chairman SHELBY. Okay.

Representative MANZULLO. They would be wiped out.

Chairman SHELBY. Why do you believe the lender groups are the biggest supporters of the proposal?

Representative MANZULLO. It is an opportunity to pick up business. It is an opportunity to do a lot of packaging to get more of the market. And what this could lead to is the more of the local real estate market you develop, the less local banks have of local real estate loans, which is their bread and butter.

So then you end up with an oligopoly of 12 or 13 or 14 of the largest lenders in the country that can end up controlling not only the mortgage, but also all the affiliated services. And that doesn't help anybody.

Chairman SHELBY. Congressman, what is wrong with the principle of total disclosure and no kickbacks?

Representative MANZULLO. Well, that is what it should be.

Chairman SHELBY. I agree with you.

Representative MANZULLO. I mean, I am just abhorred, Senator Sarbanes hit it on the head. He says, no bait and switch, adequate enforcement, and must not undermine existing rules concerning subprime borrowers. This would allow the illegal kickback. How would that help consumers?

Chairman SHELBY. Thank you for the example.

Senator Sarbanes.

Senator SARBANES. Thank you very much, Mr. Chairman.

I just want to focus on your view on the yield spread premiums. We had a hearing devoted to that subject here last year. It turned out that brokers have an incentive to up-sell borrowers. That is, they get a payment from the lender if they get the borrower to sign up for a higher rate than that borrower might qualify for. What is your view of that practice?

Representative MANZULLO. I think it all goes to the disclosure. If the interest rate is being increased in lieu of money paid upfront, that should be disclosed.

Senator SARBANES. To the borrower.

Representative MANZULLO. To the borrower, that is correct.

Senator SARBANES. Yes.

Representative MANZULLO. Complete disclosure.

Senator SARBANES. Now, Senator Faircloth, Republican of North Carolina, and former Member of this Committee, actually got much of the current debate started with an amendment directing HUD and the Federal Reserve Board to study RESPA and TILA.

Incidentally, it was that study that HUD used as the basis for the Rule, for this Rule, the one that we are talking about.

At a hearing in 1997 that he chaired, Senator Faircloth suggested, and I quote him: "There should be a requirement imposed upon the mortgage broker that the broker have an absolute fiduciary and moral obligation to represent that person to the best of the broker's ability, to the exclusion of all other interests."

Of course, the marketing undertaken by the broker's association and many individual brokers in effect tracks that. The National Association of Mortgage Brokers describes a broker as a mentor for the borrower—a mentor, a trusted adviser for the borrower. And a quick review of Internet ads reinforces the Association's claims—

mortgage brokers represent you. We shop the market for you so that you can be assured that you are receiving the best mortgage rates and terms available. What is your view about the position of trust that brokers occupy with respect to borrowers?

Representative MANZULLO. I think that the same standard would apply both to mortgage brokers and to mortgage banks, to large lenders. It is all in the disclosure.

If you call a bank and say to them, I want to refinance. It is a large bank or a small bank. And they will give you three or four different options—a 15-year, a 20-year, a 30-year.

Senator SARBANES. Yes, but the bank—the lender—it is clear to the borrower that the lender does not represent the borrower's interests. The lender is on the other side of the fence. I mean, any borrower knows that, I think probably flat out.

Now, I am asking the question, what position does the broker occupy with respect to the borrower?

Representative MANZULLO. Senator, I would say it is the same. When I practiced law—

Senator SARBANES. How can you say it is the same when the mortgage brokers, by their own advertising, represent themselves as a mentor to the borrower? They tell the borrower, mortgage brokers represent you. Or they say, we shop the market for you, so you can be assured that you are receiving the best mortgage rates and terms available.

I know when I am going to the lender, they are on the other side and I am going to shop amongst different lenders. A broker comes in and he says, look, we will do the shopping for you. We are your guy. We represent you. Isn't that the posture they occupy?

Representative MANZULLO. I think they should, and so should the bank. I think it is pretty sad if you cannot go to a bank and rely upon the information that the bank gives you. They should be in the same fiduciary capacity.

When I practiced law, Senator——

Senator SARBANES. Do you think that the bank is under an obligation to give you the best deal?

Representative MANZULLO. You bet.

Senator SARBANES. Oh, no.

Representative MANZULLO. Because they advertise the same thing.

Senator SARBANES. But they are competing with other banks, aren't they?

Representative MANZULLO. The mortgage brokers are competing with other mortgage brokers. That is the essence of competition.

Senator SARBANES. So, you think it is reasonable for a mortgage broker to steer a client into a higher interest rate and then the mortgage broker to get a payment from the lender because they brought the client into a higher interest rate?

Representative MANZULLO. If the disclosure is clear so that the consumer can understand exactly what he or she is paying—I just refinanced a farm back home. I talked to our family banker.

Maybe things are different, Senator, in the Midwest than they are here on the East Coast. But the people at Stillman Bank, from Stillman's Alley, Illinois, they have a fiduciary relationship with me. They keep my money. When I called them, I said, "Brian, I am

refinancing the farm, give me the best rate you can get." Do you know what he does? He says, let me get right back to you, and he takes a look at what he is offering out there.

I have the opportunity to call somebody else. When I bought a townhouse out here, I used a mortgage broker because I did not know these banks out here. The mortgage broker I used said not only did he find the lowest rate, but also the bank wanted to charge me $137 a month on premium mortgage insurance and the broker went to battle for me and got it down to $77 a month.

Senator SARBANES. So the broker was acting on your interest.

Representative MANZULLO. Absolutely. Absolutely.

Senator SARBANES. That is what they should be doing.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Crapo.

Senator CRAPO. Thank you, Mr. Chairman. I have no questions.

Chairman SHELBY. Senator Stabenow.

Senator STABENOW. Thank you, Mr. Chairman. Just to follow up on Senator Sarbanes' question.

It is not clear to me whether or not you are saying that—you are saying then that the fee involved is appropriate—are you saying that it should be disclosed, the mortgage broker's fees should be disclosed to the consumer? I am not understanding.

Representative MANZULLO. I believe in full disclosure. I do not understand to the Nth degree what the mortgage brokers are going to be testifying about. I do not consider that to be my role to fully understand that. But the bottom line is that whatever arrangement that is made can be taken care of in complete disclosures.

Senator STABENOW. So, do I understand, in your testimony, you are wanting to separate the Good Faith Estimate portion of the Rule from the GMP's.

Representative MANZULLO. That is correct, to separate the two, is to spend a lot of time and effort on coming up with a Good Faith Estimate that satisfies the consumers, satisfies the banks, satisfies the mortgage brokers and all the parties involved. That was the purpose of RESPA. But the bundling aspect goes backward and says you can have these kickbacks without making a disclosure of the tied agreements.

Senator STABENOW. So at this point, I just wanted to be clear. The Good Faith Estimate, locking in these numbers, full disclosure as it relates to mortgage broker fees and so on, is something that you would support.

Representative MANZULLO. The problem is, to try to lock in that interest rate when you are 30 or 60 days out—when we first bought this townhouse out here, I talked to one bank and they said, "Look. If you give us an extra 250 bucks, we will lock in between now and when you close the lowest interest rate that is available during that period of time." That is pretty good. And that is exactly what we did. I bargained that with the bank and the bank offered that.

Senator STABENOW. I think there is a difference between certainly locking in 2 months out or 1 month out and 3 days out, and what happens to people right now with Good Faith Estimates that are given 3 days from closing and change.

Representative MANZULLO. Well, yes and no. You make the application and the mortgage broker or the bank will send you an estimate, give you a range that you have to come up with at closing, say, between $2,000 and $2,500.

Senator STABENOW. Sure.

Representative MANZULLO. Then they give you the option to roll that into the loan itself or to write a check at closing and they will say, if you roll it into the loan itself, obviously, you are going to borrow more money and it is going to be more money that you pay each month on it.

Senator STABENOW. I just wanted to be clear, Mr. Chairman, as to whether or not you were saying that you supported the Good Faith Estimate and the disclosure of the YSP's. And it sounds like at this point that you are supporting disclosure.

Representative MANZULLO. I do.

Senator STABENOW. You are supporting disclosure.

Representative MANZULLO. The good-faith disclosure—to lock in a rate 3 days out, that is not a problem on there. But I do not know where locking in a rate has been a problem, especially when the banks give you the opportunity to pay a little bit more and to lock in the lowest rate within the next 60 days. And sometimes the mortgage brokers will do the same thing.

Senator STABENOW. On the GMP's—just one other question—some have talked about limiting that to the prime market versus subprime. Does that make any difference from your standpoint?

The second question I would ask is, right now, in looking at the kind of thing you are talking about—and I am very sensitive to the concerns of small business, as well as it relates to the big guys, as you say, having the ability to leverage and to be able to squeeze out small business. But, essentially, the packaging that you are talking about, the ability to do things in-house, to a large extent, exists now. They could do that right now and are choosing not to do that right now.

Representative MANZULLO. Well, we had a situation in our office, Adam McGarry, my Chief of Staff, he could tell you about the nightmare he had when he bought his townhouse in Springfield with a real estate firm that offered a one-stop-shop and had a tie-in agreement with a mortgage company. In real estate——

Senator STABENOW. That is what I am asking.

Representative MANZULLO. I am sorry?

Senator STABENOW. What do you see about the Rule that would change from what they could be doing right now and choosing not to do under this new process? Why would it be more advantageous? Why would it be more attractive to them to do what they could be doing right now but are choosing not to?

Representative MANZULLO. You mean the bundling?

Senator STABENOW. Right.

Representative MANZULLO. It would just give credence to it. It would encourage it. It would allow more of it to go on. But the key is, it would allow that secret kickback because Section 8 would be waived, which to me is astonishing, when the whole purpose of RESPA was to avoid the illegal kickback. And now, it makes the illegal kickback a legal kickback. It encourages under-the-counter transactions.

When I prepared a closing statement before RESPA, my closing statement was clearer than RESPA's has ever been. I was just a small-town lawyer. Whatever goes on—we did not deliver a piece of sod at the closing. It wasn't that archaic. But it was complete and honest disclosure of what you are doing.

Which is what all people ask in these transactions. That is what all the Senators have asked. That is all the House has asked. This legislation doesn't do that. So let's get together and concentrate on those disclosures and we could accomplish every suggestion that every Senator here has.

Senator STABENOW. Okay. Thank you, Mr. Chairman.

Representative MANZULLO. Thank you.

Chairman SHELBY. Congressman, thank you for your appearance today. And we will keep working together on this.

Representative MANZULLO. Thank you.

Chairman SHELBY. Thank you.

I now call our second panel: Charles Kovaleski, President-Elect, American Land Title Association; Gary Acosta, Chairman, National Association of Hispanic Real Estate Professionals; Catherine Whatley, President, National Association of REALTORS®; Margot Saunders, Managing Attorney, National Consumer Law Center; John Courson, Chairman, Mortgage Bankers Association; Neill Fendly, Government Affairs Chairman and Past President, National Association of Mortgage Brokers; and Ira Rheingold, General Counsel, National Association of Consumer Advocates.

I welcome all of you. I know it is a little crowded at the table. Your written testimony will be made part of the record in their entirety. I ask that you sum up your statement as briefly as you can.

We will start with Mr. Kovaleski and go from left to right.

Mr. Kovaleski, we would be happy to hear from you.

STATEMENT OF CHARLES J. KOVALESKI PRESIDENT–ELECT, AMERICAN LAND TITLE ASSOCIATION

Mr. KOVALESKI. Thank you, Mr. Chairman. My name is Charles Kovaleski and I am the President of Attorneys' Title Insurance located in Orlando, Florida. I am appearing here today as President-Elect of the American Land Title Association, which represents both title insurance companies and over 1,700 title insurance agents, most of which are small businesses.

ALTA, and I personally, would like to thank the Chairman for holding these hearings. We understand the concern that may have prompted the HUD-proposed regulations and believe that the Secretary and the Department deserves credit for the boldness of their initiative. However, we also believe that HUD lacks the statutory authority to make these sweeping changes. In fact, the ALTA has agreed to explore litigation should HUD come out with a Final Rule similar to the Proposed Rule.

We believe there will be sweeping changes in the real estate marketplace under the Proposed Rule because the elimination of Section 8 and the kickback provisions for the GMP, Guaranteed Mortgage Package, will provide a substantial incentive for packaging, just as Congressman Manzullo pointed out. Therefore, the market will move in that direction rather than toward the revised Good Faith Estimate regime.

In addition to the problems consumers face, shopping for a blind package that may or may not contain all of the services that the consumer needs, the lender will decide which attorney or title company would be part of the package. The consumer will have to accept that selection if he or she wants that loan. And since the package must include a guaranteed loan rate, only lenders can effectively offer that package. This can well lead to increased nationalization of the real estate services delivery system, thus eliminating many small, local businesses.

The HUD proposed regimes would pose particular problems for consumers in purchase and sale transactions as opposed to refinancings, which HUD apparently has focused on. In purchase and in sale transactions, the buyer and the seller have separate interests from the lender. Also either the buyer or seller may have already agreed on the selection of the provider of title or closing services before the buyer has begun to shop for a mortgage loan. As the price of the package may also include those title or closing services, the borrower could end up paying twice for the same service.

Further, in many areas of the country, as in parts of Florida and Alabama, the seller generally pays half the cost of closing and can pay all or significant portion of the title insurance charges and the governmental transfer and deed recordation charges. A recent ALTA survey found that 51 percent of our title insurance agents and abstractors in the country had less than a half-million dollars in gross revenue and a little less than three-quarters had less than a million dollars in the previous year. Sixty-eight percent had 10 or fewer employees and 42 percent had less than five employees.

By any measure, these are very small businesses. But these individuals and companies, despite that, have demonstrated over the years that they can effectively compete for the consumer's business.

HUD believes the myth that mortgage lenders will forgo the opportunity to pick up substantial packaging fees and instead will pass alleged savings on to consumers.

On the contrary, we believe, as Congressman Manzullo said, that this will simply shift revenue from settlement service providers to major lenders, providing a new revenue source for major lenders, not a streamlining of the system. Small or local firms will not have the resources to be able to offer such discounts, along with quality service to lenders, particularly national lenders. And accordingly, these smaller businesses will have difficulty competing for the consumer's business and, in fact, surviving.

Further, HUD estimates that packaging will have economic benefits because time will be saved. This time will be saved because consumers will not shop as much for settlement services and for lenders and settlement service providers will not have to answer questions about the services or prices.

ALTA believes that savings should not be achieved at the expense of consumers' knowledge and understanding of the process.

HUD estimates that small businesses will lose between $3.5 and $5.9 billion in annual revenues if their proposals are implemented. In this environment, the local attorney, small local abstractors, and title agencies will not be able to maintain service.

HUD's economic analysis concludes that lower prices will drive out the less efficient firms with no evidence of such inefficiency.

However, many counties in this country, particularly in rural areas, have only one or maybe two title companies. Packaging will eliminate some of those provides.

Consumers may not have any access to those services and will certainly have fewer choices and likely higher prices.

I will highlight an alternative to this proposal that we have recommended to HUD that will achieve many of the Agency's objectives, while minimizing consumer and industry problems.

We urge the Committee to ask HUD to seriously consider this ALTA alternative. However, we do believe that Congressional action is best to avoid any challenges.

We believe that a two-package approach will allow lenders and others to package on a local level. It will take into account local costs, needs, allocations, and allow customization.

We suggest that the HUD proposal be modified to adopt two packages, the first, a Guaranteed Mortgage Package that would consist of a loan at a guaranteed interest rate and all lender related services and charges. And second, a guaranteed settlement package that could be offered by any party—title insurers and agents, real estate brokers, lenders, escrow companies, or attorneys. It would guarantee a single price for the settlement charges that would include title and related charges, Government recording and transfer fees, and charges required for closing purposes. This approach would not include, however, a Section 8 exemption and would require disclosure of package components.

We believe that this two-package approach would better achieve HUD's goals of ensuring price certainty in the settlement process for consumers and injecting significant shoppable price competition, and a word I have heard this morning a number of times, and transparency, into both the lending and settlement industries.

I thank the Committee for the opportunity to participate this morning. We encourage HUD to move slowly and very carefully on this proposal.

Thank you, Mr. Chairman.

Chairman SHELBY. Mr. Acosta.

STATEMENT OF GARY E. ACOSTA
CHAIRMAN, NATIONAL ASSOCIATION OF
HISPANIC REAL ESTATE PROFESSIONALS

Mr. ACOSTA. Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, I am Gary Acosta, President of SDF Realty in San Diego, California, and the Chairman of the National Association of Hispanic Real Estate Professionals, or NAHREP, a nonprofit trade association dedicated to increasing the Hispanic homeownership rate. NAHREP is the Nation's fastest-growing real estate trade organization and is a partner in President Bush's "Blueprint for the American Dream" minority homeownership initiative. We appreciate the opportunity to address the Committee today on the views and planned actions of the U.S. Department of Housing and Urban Development on the proposed amendments to RESPA.

NAHREP has over 10,000 members in 43 States. Our members come from all segments of the housing industry, including, but not limited to, real estate agents and mortgage professionals. NAHREP

provides professional education, industry representation, publications, and technology solutions for those real estate professionals primarily dedicated to serving Hispanic homebuyers.

Today, the homeownership rate in the United States stands at 68 percent; however, for Hispanic Americans it is about 47 percent. This disparity is driven by a number of factors including the lack of competitive mortgage financing in those markets. In addition, NAHREP estimates that approximately 80 percent of Hispanic homebuyers are first-time homebuyers—double the percentage of the overall market. Particularly for the first-time buyer, the purchase of a home is both a complicated and emotional experience, which often creates a more labor-intensive real estate transaction for the professional.

Additionally, many Hispanic consumers have thin credit files, little money for down payment, and prefer to speak Spanish. In order to serve this market effectively, mortgage and real estate professionals must have specialized skills and have a keen understanding of this market. Accordingly, NAHREP supports policy and legislation that increases awareness, reduces cost, and simplifies the process of buying a home. In this regard, NAHREP applauds President Bush and Secretary Martinez for their demonstrated commitment to make homeownership attainable for more Hispanics, minorities, and other underserved Americans.

A recent NAHREP member survey indicated that 81 percent of our members who are real estate agents "regularly use the services of a mortgage broker to arrange financing for their clients." Latinos are more likely to use mortgage brokers and other small business professionals because they tend to live and to work in their communities and they tend to have strong language skills and cultural understanding. Today's mortgage industry is increasingly a formula-driven, high-volume, low-margin business. Larger players generally lack the flexibility and diverse personnel necessary to adequately serve homebuyers that do not always "fit in the box." For this reason, NAHREP believes that the growth in Hispanic homeownership will depend in large part on Hispanic-owned small businesses in those communities.

NAHREP recognizes that HUD's Proposed Rules are designed to simplify the mortgage finance process and eliminate opportunities for predatory lending practices.

NAHREP shares HUD's conviction that consumers should receive accurate information when choosing a mortgage originator in order to make an educated decision regarding mortgage products and services. We also believe that this outcome for the consumer could not be possible without real competition in the mortgage market. However, we see the potential for both the Enhanced Good Faith Estimate and the Guaranteed Mortgage Package to have unintended and detrimental effects on small real estate and mortgage companies that may prove to undermine the intended benefits to some consumers.

NAHREP believes that placing small business owners at a disadvantage will ultimately hurt homeownership opportunities for the minorities that NAHREP and others want to reach.

This Proposed Rule in connection with the Enhanced Good Faith Estimate results in "different treatment of compensation in loans

originated by lenders and those originated by mortgage brokers." This unequal treatment will create an uneven playing field among the mortgage originators and the disadvantage mortgage brokers compared to mortgage banks and lenders. In some cases, a consumer can select a more expensive product by assuming that the loan with no disclosed compensation to the originator is always the better deal.

The proposed changes to the Good Faith Estimate include a mandate to guarantee third-party costs within a "10 percent" or "zero" tolerance. NAHREP believes this is critical in helping consumers identify the best mortgage possible. Holding mortgage originators responsible for making accurate disclosures to consumers within 3 days of application is appropriate and reasonable and will eliminate abuse of the Good Faith Estimate.

However, loan originators do not have control over certain third-party costs. There are many examples of legitimate, unexpected costs that arise between application and closing.

NAHREP recommends that when a price increases or a fee is added that changes the original Good Faith Estimate, a new Good Faith Estimate should be provided to the consumer within a reasonable timeframe along with a written explanation for the change. And this must take place before the consumer is at the settlement table.

NAHREP also cautions HUD to consider the impact to small businesses of the proposed Guaranteed Mortgage Package. While we cannot know the exact impact to the marketplace of a GMP, we believe the packaging of settlement services offers a much greater business opportunity for large lenders than for small mortgage brokers or small real estate services providers and could ultimately hurt the consumers served by small businesses.

The housing sector has been one of the few bright spots in our economy and Hispanic homebuyers have fueled the strength of our housing industry. Over the next two decades, nearly 80 percent of all new homebuyers will be minorities and/or immigrants. Again, I appreciate the opportunity to be here today to express NAHREP's support for Secretary Martinez's effort to improve the process and reduce the cost of mortgage finance. The cautions I have expressed today are intended to ensure that this effort results in the best possible outcome for consumers and the mortgage finance industry. I look forward to working with this Committee and HUD to ensure that a Final Rule will encourage more minority-owned small businesses to enter the real estate and real estate finance market and thereby help to increase homeownership opportunities, particularly for minority families.

Thank you.

Chairman SHELBY. Ms. Whatley.

STATEMENT OF CATHERINE B. WHATLEY PRESIDENT, NATIONAL ASSOCIATION OF REALTORS®

Ms. WHATLEY. Good morning, Mr. Chairman, Senator Sarbanes, and Members of the Committee. My name is Cathy Whatley and I am the President of the National Association of REALTORS®, representing over 860,000 practitioners in all areas of residential and commercial real estate brokerage.

I thank you, Mr. Chairman, for holding this hearing and appreciate the opportunity to be with you today to discuss our views on HUD's RESPA reform proposal.

Let me state that the National Association of REALTORS®, supports the goals set by Secretary Mel Martinez to simplify and to improve the mortgage process and to reduce settlement costs for consumers. However, while well-intended, we do not believe this proposal will achieve those results.

HUD assumes the Guaranteed Mortgage Package will result in increased competition, thus driving down the cost of the transaction. We disagree with that premise. We believe that HUD has failed to fully consider the disruptive impact that this proposal will have on the industry and the consumer.

Let me explain what I believe are three likely outcomes of the Guaranteed Mortgage Package proposal.

First, competition will decrease. This proposal creates a competitive advantage for larger lenders. It presumably allows anyone to package. However, since the Guaranteed Mortgage Package must include a guaranteed interest rate, it is difficult to see how any entity other than a larger lender will be able to compete effectively.

Lenders will determine which service providers are included in the package. Realtors and other service providers will be hampered from competing and basically prohibited from offering their packages to the consumers unless the lender is willing to accept the package. Thus, the largest lenders will determine the winners and losers in the new world of packaging and consumers will have fewer choices.

Second, transparency in the transaction will decrease. Today, services required to close the transaction are fully disclosed to the borrower. To move to a process where the borrower is assumed to only be interested in a lump-sum price of the package and not the individual services is flawed.

Despite claims to the contrary, consumers want to know what they are getting for their money. If they do not know what services are in a lender package, they will not be able to comparison-shop, which was to be a key component of HUD's new Rule.

Third, and critically important, we also believe the cost of the transaction may actually increase. Our biggest concern lies with the proposal to remove the consumer protection provision of Section 8 for the offering of a Guaranteed Mortgage Package. Granting lenders an exemption from this provision will permit lenders to charge whatever they want for these services without any assurance that the cost to the consumer will be lowered. As a result, the cost of the transaction could, and probably will, increase.

Before HUD removes the most significant consumer protection provision in RESPA, it should more fully disclose and understand the consequences to the industry, as well as the consumer.

Today, we enjoy a healthy market for settlement services. The Guaranteed Mortgage Package proposal may move us in a direction that threatens this environment. We believe the goals of reform can be achieved without sacrificing the important consumer protections of Section 8.

NAR recommends HUD take an incremental approach to reform by first improving the Good Faith Estimate. The Good Faith Esti-

mate can be improved by imposing some pricing discipline on lenders that will provide borrowers more certainty early in the process and enable them to shop and compare loans. In addition, clarifying that volume discounts are permissible should encourage lenders to seek discounts that can be passed on to the consumer.

The Good Faith Estimate can become a better shopping tool if redesigned and some enforcement mechanisms are provided.

We think it is a better approach to build on what the consumer and the industry already knows, rather than taking a giant leap of faith that is required if HUD pursues its Guaranteed Mortgage Package before it conducts appropriate analysis.

Chairman Shelby, this packaging concept is not wholly without merit. But the unintended consequences of this Proposed Rule could be devastating. We feel it is imperative for HUD to understand and undertake additional research before moving forward to finalize this Rule. We recommend that HUD issue a new Proposed Rule that reflects this research, as well as the comments by all affected parties. The potential consequences to the industry and to the consumer are too great not to take this approach.

I thank you, Mr. Chairman, on behalf of the National Association of REALTORS® for the opportunity to testify today.

Chairman SHELBY. Thank you.

Ms. Saunders.

STATEMENT OF MARGOT SAUNDERS
MANAGING ATTORNEY, NATIONAL CONSUMER LAW CENTER
ON BEHALF OF THE
CONSUMER FEDERATION OF AMERICA, CONSUMERS UNION
AND U.S. PUBLIC INTEREST RESEARCH GROUP

Ms. SAUNDERS. Mr. Chairman, Senator Sarbanes, and Members of the Committee, I appreciate the opportunity to be here today.

I am representing not only the low-income clients of the National Consumer Law Center, but also the Consumer Federation of America, Consumers Union, and the U.S. Public Research Group.

We wish to commend Secretary Martinez for the dramatic approach to RESPA reform that he has advocated in these Proposed Rules. We applaud many of the positive features of the Rules and we commend HUD's steadfast commitment to ensuring that consumers benefit from the Rules.

There are real complexities in these Proposed Rules, with dramatic impact on determining compliance with the Truth in Lending Act and the Home Ownership and Equity Protection Act. We want to make it absolutely clear that we support HUD's efforts to protect consumers through the Proposed RESPA Rules. While we have concerns with a number of important details, these should not be regarded as diminishing our overall support for the basics of HUD's proposals.

Now, HUD has proposed three separate components to the Rules, and I think that it simplifies it if I analyze these components separately.

The first, and probably the least controversial, although quite controversial I know with some members of this panel, is the proposal to deal with yield spread premiums. As you know, Senator

Sarbanes held a hearing about a year ago regarding Secretary Martinez's policy statement issued in 2001.

We all know that there is tremendous controversy over the legality and the morality of the payment of lenders' fees to brokers which are not fully disclosed and controlled by the consumer. There were a substantial number of class action lawsuits by consumers to challenge the payment of these fees when consumers did not know they were made and did not feel that they had received the benefit of these yield spread premiums.

The driving force behind HUD's proposal today was to deal with the raging controversy over yield spread premiums. And in fact, the Guaranteed Mortgage Package was a creation of a group that included the lenders, the brokers, consumers, and HUD as a mechanism to allow brokers to continue shielding the full disclosure of how much the lenders were paying them, yet still ensuring that the consumer got the full benefit of the bargain for which the consumer was shopping.

So, we have the yield spread premium proposal by HUD, which we fully support. However, as good as the proposal is on disclosures on yield spread premiums, HUD fails to put that proposal in the proper section of the regulations so that it would be enforceable.

There is no private right of action for failing to make disclosures properly under RESPA. The only private right of action is for kickbacks. In order for the yield spread premium proposal to be really effective and enforceable, it must be in a different section of the regulations.

The second component of what HUD has proposed is to make the Good Faith Estimate—that disclosure that is provided 3 days after application—more meaningful. HUD proposes to say that when a lender or an originator of any kind—broker or lender—proposes to tell the consumer what the closing costs will be, those estimates must be more than just wild guesses. They must bear some reasonable semblance to reality. And HUD has proposed that there be only a tolerance of 10 to 20 percent between what is estimated upfront and what is actually charged at the end.

The third proposal, the Guaranteed Mortgage Package, is what has drawn the most fire. While many of us agree with the overall goal of this proposal, the consumer groups that I represent have an overarching concern. And that is that unless the proposal is worked out with the Federal Reserve Board, the Guaranteed Mortgage Package, as it is currently proposed, will have the effect of potentially masking some predatory loans and of removing from the consumers the ability to challenge loans for not being properly disclosed and for not including all the protections they are required to include.

So just to sum up—and I see that I am out of time—I would emphasize that HUD can move forward on all three of these components if they move forward carefully in coordination with the Federal Reserve Board and to continue their current orientation toward protecting consumers.

Thank you. I will be glad to answer any questions.

Chairman SHELBY. Mr. Courson.

STATEMENT OF JOHN A. COURSON
PRESIDENT & CHIEF EXECUTIVE OFFICER
CENTRAL PACIFIC MORTGAGE COMPANY
ON BEHALF OF THE
MORTGAGE BANKERS ASSOCIATION OF AMERICA

Mr. COURSON. Thank you and good morning, Mr. Chairman, Ranking Member Sarbanes, and Members of the Committee. Thank you for inviting the Mortgage Bankers Association to these important discussions on RESPA reform.

Last year, driven by historically low interest rates, American consumers, working with local lenders across the country, borrowed $2.4 trillion to finance their piece of the American Dream. Too often, however, they just paid too much at closing. Overly complex, confusing, and burdensome settlement procedures have created a system that stifles competition and abets fraud. It is a system that works against the best interests of consumers.

HUD's Secretary Martinez has proposed bold and far-reaching reforms of the mortgage disclosure system. These reforms warrant the attention of the Senate because the current system is something that so many of your constituents want changed.

For years, we mortgage bankers have heard complaints about the difficulties and complexities of the mortgage process. For too long we have understood that the intricacies of the mortgage disclosure system served to confuse consumers, to hide unnecessary fees and, in some instances, to defraud borrowers into higher-price loans.

Mr. Chairman, I compliment you for your interest in this subject and for holding this hearing. And I compliment the Secretary. Under Mel Martinez's leadership, HUD has stepped up to the plate and delivered to us a blueprint to resolve large portions of the problems that currently plague the mortgage disclosure system.

We believe that the guaranteed fee package framework set forth in HUD's Proposed Rule has great benefits for all consumers and goes a long way to improving existing disclosure systems.

We are very confident that HUD's package proposal will achieve three very important objectives: It will simplify disclosures. It will provide consumer certainty. It will foster competition. Let me just reiterate: Simplification, certainty, and competition. Please allow me to explain.

The central element of HUD's proposal fosters the much-needed simplification by creating a regulatory framework in which a prospective borrower may be quoted a single guaranteed price to close the loan. The guaranteed closing cost, combined with an interest rate guarantee that has been paid to an index, will allow the prospective borrower to make an apples-to-apples comparison between mortgage loan products using just two numbers.

This is something that consumers absolutely want and can use to bring market forces into play on their behalf. The reason why this simplified disclosure is of such benefit to consumers, however, is because, based upon the second important aspect—certainty.

Under the Proposed Rule, HUD would require that cost disclosure for mortgages be provided as an up-front, rock-solid guarantee of the costs associated with the loan transaction. Such a solid guarantee will truly empower consumers to comparison shop with effectiveness and certainty.

We are also confident that HUD's package proposal will not only simplify disclosures and demystify the loan process, but also will foster real competition. By giving consumers early, simple, and solid cost information they will be able to compare and negotiate in ways they cannot do today. This ability to shop will vigorously spur competition and lower market prices.

We believe that the increasing competition will actually foster and enhance market opportunities for our small and mid-sized lenders. Equally important, this new system will provide consumers with a potent weapon to protect themselves against fraud and bait and switch tactics. With one single glance at the new binding disclosure, consumers will be able to discover any discrepancies and enforce their rights. It provides maximum transparency with increased competition that will maximize market efficiency.

To conclude, I reiterate that MBA welcomes HUD's proposals and the new responsibilities that are placed on our members to ensure that consumers receive better information in the mortgage process. With some adjustments, the guaranteed cost packaging proposal advanced by HUD is a viable system that is certain to result in broad consumer benefits.

Mr. Chairman, I thank you for the opportunity to appear today and look forward to answering your questions.

Chairman SHELBY. Thank you.

Mr. Fendly.

STATEMENT OF NEILL FENDLY
GOVERNMENT AFFAIRS CHAIRMAN & PAST PRESIDENT
NATIONAL ASSOCIATION OF MORTGAGE BROKERS

Mr. FENDLY. Chairman Shelby, Senator Sarbanes, and Members of the Committee, thank you for inviting NAMB to discuss the impact of HUD's Proposed RESPA Rule and what it will have on consumers, as well as small businesses, particularly mortgage brokers.

Mortgage brokers are typically small businesses who operate in the communities in which they live, often in areas where traditional mortgage lenders may not have branch offices.

A mortgage broker does not simply press a few keys to provide the consumer with a mortgage loan. Nor are mortgage loans akin to products that can be picked from a shelf and paid for at checkout. Mortgage brokers perform a vital and unique role in assisting consumers in obtaining a mortgage loan. Indeed, this is why mortgage brokers originate more than 60 percent of all residential mortgages and are also the key to bridging minority homeownership, as recently cited in a study by Wholesale Access.

Chairman Shelby, our members are absolutely terrified about the impact that HUD's Proposed Rule will have on their ability to continue originating mortgages. They fear that HUD's Proposed Rule, if finalized, will forever cripple their ability to do what they do so well—putting families in homes.

NAMB believes that HUD's Proposed Rule does not achieve HUD's stated goal—to simplify the mortgage process—but instead, achieves just the opposite. It will confuse the consumer and have the effect of limiting consumer choice and access to credit.

HUD's proposal will substantially increase the regulatory burden on small businesses while accomplishing none of HUD's stated

goals. Further analysis is necessary to ensure that the Proposed Rule's impact on the housing market is based on a foundation of market realities and not just good intentions.

NAMB has grave concerns with HUD's recharacterization of a yield spread premium. The Proposed Rule recharacterizes a yield spread premium as a lender payment to the borrower for a higher interest rate. This characterization creates some unintended consequences and provides less clarity to consumers than is presently disclosed.

The FTC expressed similar concerns stating that HUD's disclosure of broker compensation could confuse consumers and lead them to misinterpret the overall cost of the transaction. This recharacterization is also inconsistent with HUD's 1999 and 2001 Statements of Policy in which HUD states that goods, facilities, or services can be furnished or performed for the lender, as well as the borrower.

NAMB does not believe that RESPA reform should create an unlevel playing field among originators or, in essence, pick winners or losers. Unfortunately, the Proposed Rule does just that. It requires only mortgage brokers to include their indirect compensation in the calculation of net loan origination charge, but it does not require the same of all originators.

HUD even acknowledges that their proposal results in different treatment of compensation in loans originated by lenders and those originated by mortgage brokers.

HUD's new calculation will complicate a consumer's ability to shop because the consumer will be unable to perform a true apples-to-apples comparison of the cost of the mortgage.

The FTC stated that HUD's asymmetric disclosure of compensation for mortgage brokers might inadvertently burden consumers and competition. This is a perverse impact of a Rule that is being implemented to help consumers.

The Proposed Rule tilts the playing field by encouraging packaging and this will devastate small businesses since they do not have the bargaining power to enter into volume-based discounts with third-party settlement service providers as do larger entities.

In addition, NAMB believes that HUD did not sufficiently comply with the Regulatory Flexibility Act in promulgating their Proposed Rule. HUD's economic analysis is inaccurate and incomplete. It does not provide a clear picture of the Proposed Rule's impact on a housing market that is functioning remarkably well, nor does it accurately reflect its impact on small business.

The NFIB and SBA expressed concerns. They asked HUD to issue revised initial regulatory flexibility analysis to address the specific impact that the Proposed Rule will have on small business.

HUD's failure to accurately analyze the economic impact on small business can also be illustrated through their own reported inconsistencies. For example, HUD's Paperwork Reduction Act submissions to OMB states that the annual responses for Good Faith Estimates is 11 million. However, HUD's analysis states that if the Rule were applied in the year 2002, it would impact 19.7 million applications. This is very significant because the submission to OMB under-estimates the paperwork burden by at least 8.7 million

GFE's. This is an inconsistency that demonstrates HUD's lack of due diligence and could cost small business millions.

HUD states that the program change being mandated would increase the burden on industry by 2.5 million burden-hours. HUD has testified that this is a one-time transition burden. This one-time transition burden, equal to 289 years, will eradicate small business in the mortgage industry.

The extreme burden that HUD's Proposed Rule forces on small business will not only dismantle small business, but it will also alienate consumers from the dream of homeownership.

NAMB has a long history of supporting the reform of mortgage laws and we recognize that the laws are complex for both industry and consumers. NAMB has submitted an alternative disclosure form set forth in its comment letter that satisfies HUD's objectives to simplify and clarify the disclosure of settlement costs, but not at the expense of small business or to the detriment of consumers.

It will allow the consumer to perform a true apples-to-apples comparison of the cost of the mortgage while maintaining a more level playing field for mortgage originators.

We commend you, Chairman Shelby, for convening this hearing on this terribly important issue. We ask the Committee for its support to request HUD to revise their Proposed Rule so that it accomplishes HUD's stated goals and objectives to simplify the mortgage process and increase homeownership while not creating competitive disadvantages in the marketplace.

Thank you.

Chairman SHELBY. Mr. Rheingold.

STATEMENT OF IRA RHEINGOLD
EXECUTIVE DIRECTOR & GENERAL COUNSEL
NATIONAL ASSOCIATION OF CONSUMER ADVOCATES

Mr. RHEINGOLD. Thank you, Mr. Chairman, and Members of the Committee, for holding this hearing and allowing us to offer our perspective on the impact on consumers of HUD's proposed changes to RESPA.

As I listened to others speak and as I engaged in conversation with people from the industry about RESPA reforms, I am incredibly struck by how different our perspectives are, and the extent that we almost live in parallel universes. It is important as I talk about the consumer perspective to talk about what lens we are looking at. What is the prism that we see HUD's proposal from?

My perspective is as a long-time legal aid lawyer who worked in Chicago for a number of years representing homeowners who were faced with foreclosure. And when we look at the HUD's settlement process, we look at HUD's reforms, what we look to is whether the reforms make it easier, simpler, and fairer to those consumers who shop for mortgages, and we also look at where and how the new proposed system will enable mortgage lending abuses to continue against less sophisticated borrowers.

So there are some things that we look at: Will it be fair? Will it be easier? And will it allow consumers to have real choice in buying a home or in taking out a mortgage? In addition, we look at the HUD proposal to the extent it will allow the proliferation of mortgage abuses.

Overall, our perspective about HUD's attempt to change the Rules are that they are good and that they are necessary. The current system that we have today, while to a large extent working well in the prime marketplace, is not consumer-friendly. Anybody who believes that it is consumer-friendly clearly has not signed any of the myriad of documents they have had to do when they have gone to a closing process.

I know as someone who has bought a home and who has refinanced a home, my wife looks to me as the expert to handle those documents. And I say, sure, honey, just sign. But in fact, I am not quite sure what is going on there, either. I would like to think that I am about as sophisticated at looking at a HUD–1 as anybody who is sitting here.

The move to simplify is important. It makes shopping easier and it is a good idea.

The move to make the bait and switch less likely, particularly in the context of the Good Faith Estimate, is a good idea. A Good Faith Estimate needs to be more binding and that is an excellent proposal.

A move to make the mortgage broker industry more accountable is an extremely good idea. They need to be accountable to their customers, who are their principals. And in the current system that we have today, there is no accountability.

Do the RESPA Rules accomplish these important goals? In a very general sense, they do.

What do we like? The GMP, the package, it is crucial that the package provide a guaranteed interest rate and a cost package. We have heard people from industry saying that the cost package alone is sufficient. That is absurd. If you have a cost package without an interest rate, what happens is that any additional costs get pushed into the interest rate. It has to have both.

A more binding GFE, again, is extremely important. In my experience at looking at thousands of HUD–1's, and thousands of GFE's, there is no greater worker of fiction—well, two—as a Good Faith Estimate or a loan application. Mind-boggingly how different they turn out to be than what the original loan is.

The people involved in sitting at the table and making those loans, they know what those costs are and they know it pretty closely, and there is no reason why that is not binding.

The recharacterization of yield spread premiums, I cannot imagine anything more important to protect consumers. I find it interesting that we talk about yield spread premiums and how disclosures work and it is fair because people—once it is disclosed to them, they will understand what is going on with the yield spread premium.

I have talked to so many consumers and I have looked at loan documents and I want to see that first consumer who looks on that HUD–1 and it says, YSP, POC, $3,000, and they understand what that says. Nobody understands that. Not only do they not understand it, they also do not understand it because it says, YSP, POC, $3,000, they are paying a higher interest rate than they otherwise would have qualified for.

So those disclosures do not work, period. And recharacterization is crucial.

I will sum up because I think this is very important. The point Ms. Saunders mentioned is something that we also are extremely concerned about.

The proposal that HUD talks about, particularly the GMP, I believe works in a marketplace where people actually shop, where prices are fair and they are based on real market-driven decision-making. And that is the prime market.

The subprime market, there is no shopping going on. We have captive audiences. And a proposal that emphasizes shopping that would work in the prime market simply does not work in the subprime market and we simply need, if we are going to go forward with the Guaranteed Mortgage Package, it needs to be limited to the prime market.

If anybody has any questions, I would be glad to answer them. Thank you.

Chairman SHELBY. Thank you.

Mr. Acosta, I will start with you. I was interested in your analysis of how HUD's Proposed Rule would impact minority families' ability to get into homes, especially in the Hispanic market. Would you explain again for us, or elaborate on the role that brokers play in the communities like yours, and how the Proposed Rule change in its present form, what it would do to your area?

Mr. ACOSTA. Sure, Mr. Chairman.

First of all, it is important to understand that Hispanic homebuyers have in many cases unique challenges. As I mentioned in my testimony, language barriers. Many Hispanic homebuyers are immigrants, tend to have less money for a down payment, tend to have thin credit files. There is cultural issues that also come into play as well.

So our analysis tells us that, in large part, it is the small mortgage brokers, the small business professionals that are doing the heavy lifting in those communities. They tend to have the flexibility. They tend to come from the community. We are fearful that some of the proposals that HUD has put on the table will make it more difficult for them to compete. And if there is less small business professionals in the marketplace, we believe that that will have a negative impact on Hispanic homeownership.

Chairman SHELBY. Ms. Whatley, what would you assume would be the impact on settlement costs if there is not a requirement that each individual service provider disclose their costs?

Ms. WHATLEY. Let me reiterate, Mr. Chairman, that I certainly think that costs will increase. We obviously have some differences of opinion here on the panel.

Chairman SHELBY. Sure.

Ms. WHATLEY. From my perspective, I think any time that you have a packaged approach in which there is no transparency, in which the consumer does not know what is included in the package, it would be very difficult to shop because how would you even know what you were comparing from one to the other, whether or not every package contained the same elements. Not only that, you have no ability to determine who the service provider is within the package. And because of that, maybe the quality of the service is less than what you would expect as a consumer.

From the real estate professional's point of view, we are the ones who are most closely connected throughout this entire transaction with the consumer. They look to us to help them understand what is involved in the process, help to guide them through this process. We literally work with vendors day in and day out. We meet the home inspector. We meet the pest control company. We can help the consumer to understand those people who have the ability to deliver and who have a quality of service that they are expecting. And when there is a nontransparent black box of providers in which we have no ability to have a dialogue with the consumer about those choices, it becomes a little bit more difficult.

Chairman SHELBY. What about kickbacks? The idea of kickbacks grates on a lot of us.

Ms. WHATLEY. Well, certainly, included in the package, there is no requirement for the packager, even if they are able to deliver at a lower cost, to pass that along to the consumer.

And if the overall approach of HUD is to have cost savings, I think that the design in its present form eliminates the ability for the consumer to know whether or not they have any savings at all, whether those savings are going to the packager.

Chairman SHELBY. Mr. Courson, in your written testimony, you assert that: "In a competitive environment, any price reduction achieved by the packager will surely be passed along to the consumer." That sounds good. Can you tell where in the Proposed Rule it requires you to pass those savings on to the consumer?

Mr. COURSON. Obviously, Senator, as we are all well aware, there is no requirement within the Rule itself.

Chairman SHELBY. Sure.

Mr. COURSON. However, I think it is important that, as today, with the settlement costs that are out there, the consumers are not getting the best transaction because they are not shopping a menu, if you will, of individual services. With one number and one figure that they can go shop, in addition to the interest rate, competition will drive those costs down.

Remember that consumers that are having their application taken, which this disclosure is given 3 days after that, are being taken on the local level by mortgage brokers, by small local lenders, by community banks. And so, by doing that, there will be a robust group of people who are taking applications and making meaningful disclosures to the consumers.

Chairman SHELBY. Wouldn't the packagers have more incentives to pass on savings if the costs were disclosed? In other words, if the consumer knew what was there, there was nothing hidden?

Mr. COURSON. You know, Senator, the key here is a meaningful disclosure. Meaningful to the consumer when they come to one of our offices is, tell me what is my interest rate, what is my payment, and how much cash do I have to bring to closing?

So, I think the meaningful piece and simplification, simplification of giving them a number that they can go shop, is going to be the best assistance to that consumer.

Chairman SHELBY. Senator Sarbanes.

Senator SARBANES. Yes, thank you very much, Mr. Chairman.

I wanted to, for the moment, narrow my focus down from the Guaranteed Mortgage Package and down from the Good Faith Esti-

mate, both concepts of which involve a number of complications and done the right way, might be helpful, done the wrong way, would be harmful. But I want to get more narrow in the focus of this question. I wanted to discuss yield spread premiums, which of course could be addressed without either the GMP or the GFE.

I want to ask, why this yield spread premium ought not to be credited to the borrower? If the borrower is being brought to a higher interest rate than the borrower might otherwise qualify for, and the lender who is receiving this higher interest rate is prepared to make a payment for it, so to speak, why that money shouldn't go to the borrower, who is the one paying the higher interest rate.

So it is a straight trade-off. I pay a higher interest rate, then I get the benefit of the yield spread premium.

I would like to ask each of you what you view is on that question. Mr. Kovaleski.

Mr. KOVALESKI. I think we agree with Chairman Manzullo, and that is that the disclosure of all the costs, including the yield spread premiums, is necessary to make this a transparent transaction so that the buyer knows what he is paying for, for what and to whom.

Senator SARBANES. Well, we will look at the disclosure in a little bit, whether what is being provided—do you regard current disclosures as anywhere near approaching adequate for this purpose?

Mr. KOVALESKI. The disclosure may be. The explanation perhaps is not.

Senator SARBANES. It is not adequate?

Mr. KOVALESKI. Perhaps it is not.

Senator SARBANES. Mr. Acosta.

Mr. ACOSTA. I think what is important to emphasize is that we believe in competition. Now yield spread premiums I think for the most part are generally credited to the consumer in some capacity.

Senator SARBANES. HUD says that at least 50 percent of it on the basis of their study does not go to the consumer.

Mr. ACOSTA. Well, I think I have a unique perspective in this in that I have worked for a bank. I have been a mortgage broker and I am currently a mortgage banker. And I can tell you that some of the concerns that have been brought up here today are no less prevalent in the mortgage banking arena than they are in the mortgage broker arena.

Loan originators working for banks or mortgage bankers routinely get compensation for what is called overage, or by increasing the interest rate as well. So it is not limited to mortgage brokers.

Our concern is not that disclosing yield spread premiums is a bad thing. We think it is a good thing. Our concern is that there should be something that is equivalent for mortgage bankers and bankers as well. And we think that that is of fundamental importance. I also agree with a couple of my colleagues in that we think that a lot of this could be resolved by putting some teeth to the Good Faith Estimate. I think that right now, it is too fast and too loose. There is no accountability to the originators, and that applies to both bankers and brokers. We think that can be done, and should be done.

Senator SARBANES. Ms. Whatley.

Ms. WHATLEY. Well, Senator, I am not a mortgage broker. So, my comments will probably be a little different than those who are expert in that particular area. But certainly, the yield spread premium as a conversation with the consumer up-front should help them to understand that it is predominantly to reduce cost.

Full disclosure is very important. And the consumer should be able to have a dialogue with their mortgage lender to determine whether or not they are going to pay a higher interest rate and thus, get a compensating benefit to them and lower closing costs up-front, or whether or not they are going to have a lower interest rate and they will pay those funds out of their own reserves.

Senator SARBANES. Do you think they should get the benefit of the higher interest rate by getting, somehow or other, the offset against their closing costs, the consumer?

Ms. WHATLEY. When I am working with customers in my office and they come in and we are having a dialogue about whether or not they want to have a 6 percent interest rate or a 6½ percent interest rate, they may be able to wind up at 6 percent. They may be paying points. Maybe they are not. Maybe it is 6½ because they do not necessarily have enough money for the closing costs, so they actually will pay a higher interest rate to either pay reduced closing costs or have credits given to them at closing where they do not have to bring as much money to closing.

Senator SARBANES. But if I am the consumer and I am led into paying a higher interest rate than I otherwise would qualify for, and then the receiver of the higher interest rate, the lender, pays out money because he has gotten this higher interest rate, and that money doesn't come to me, the borrower, but it goes somewhere else, I am being taken for a ride, aren't I?

Ms. WHATLEY. I think as long as the consumer has full understandable disclosure and the consumer is making a decision about whether or not he or she feels the value of the service that is being provided to them is reasonable, maybe that in and of itself is of benefit to the consumer. They may want to work with their friend, Cathy Whatley. And because of that or other reasons, they believe that the fees are reasonable and fair.

Again, I am not a mortgage broker, so I have not sat through those dialogues that the consumer has when that individual is having a discussion. That is a privacy issue. So it is generally not something where the real estate broker may necessarily be sitting in as the loan application is being taken. Sometimes they are, sometimes they are not.

Senator SARBANES. Ms. Saunders.

Ms. SAUNDERS. Senator Sarbanes, I think absolutely the consumer should be given the full benefit of the yield spread premium.

I would like to quickly address what you were mentioning before, which is the big difference between a mortgage broker and a mortgage lender, which is why an equivalent disclosure is not really necessary.

When a consumer goes to a lender, as you know, the consumer expects to be given a price, hopefully the best price of that lender. But the consumer knows that that lender is only providing the service that the lender provides.

When the consumer goes to a broker, they are told, and I am quoting from an Internet search by brokers—"We shop the market for you so that you can be assured that you are receiving the best mortgage rates." We select the best lender from our many sources to provide you with a loan that meets your individual needs.

The law says a lender does not owe a fiduciary duty to a consumer when the lender is simply engaged in a credit relationship. The law is unclear as to whether the broker owes a fiduciary duty.

The point here today is that the broker holds himself or herself out to the consumer as the consumer's representative, the mentor, as you pointed out. And given that, any payment that the broker receives from anybody except the consumer should be explained to the consumer so that the consumer knows that the broker is not just responding to the consumer's needs, but is also getting paid for something by somebody else that may serve to dilute the broker's sole allegiance to the consumer's best interests.

That is exactly what has happened with the yield spread premiums. There are payments coming to that broker from two different sources—both the consumer and the lender. When the lender pays the broker something, the consumer ends up paying more in the higher interest rate. And that is the problem that this entire Rule was designed to resolve—how to deal with the diverse methods of compensating the broker and make sure that the consumer only is the main person that pays the broker, so that the entire yield spread comes to the consumer and the consumer controls it.

Senator SARBANES. Mr. Courson.

Mr. COURSON. Senator, we had the privilege of testifying at the hearing that you had on the yield spread issue about a year ago, and continue to support the disclosure of yield spread premiums.

Your specific question on the credit to the borrower on the Good Faith, we really haven't taken a specific position, but I urge some caution in the way that could transact in that if there is a credit to the borrower, and then there would be an offset, if you would, of some or part of that as broker compensation, there could be a double counting in terms of the fact if you have a higher interest rate and the broker compensation, you could be double-counting. So there is a technical question that needs to be looked at.

But having said that, we do support and have supported, along with the coalition of our fellow lending groups, disclosure of a yield spread and we submitted it as an exhibit at your heading, the disclosure form, that in effect says, here is the compensation that the broker will receive. Here is that relationship. And then giving the borrower the opportunity of choosing whether to pay that compensation in a fee, pay it through a higher interest rate, or pay it through a combination of the two.

It is not on the record with this Committee, or the Committee with Chairman Sarbanes at the time. That is a document that we still support today.

Senator SARBANES. Mr. Fendly.

Mr. FENDLY. Senator, I have a number of comments to make with respect to that question.

First of all, we do believe in complete and total disclosure. Attached as part of our testimony is a Good Faith Estimate* that we designed and submitted to HUD early last fall which clearly lays out exactly what a yield spread premium will and won't do, along with a generic example. In fact, it covers it twice.

I think one of the things that concerns me is when I hear about a benefit dollar to dollar to a consumer. It is well acknowledged, we deal with wholesale lenders, not retail lenders. Wholesale lenders. The rate that we quote to the borrower that covers our compensation in total is a rate that is shopped out in the marketplace.

Now unless somebody's going to convince me that 60 percent of this populace does not even bother looking at a paper or TV or radio, that rate still has to be competitive. As current law states, it is for the benefit of both the lender and the borrower.

We have a problem when we decide that we need to transfer any upgrade rate that we sell in order to cover costs, benefit for benefit, dollar for dollar, to the borrower. That represents a significant problem.

One of the things I would like to talk about briefly——

Senator SARBANES. I am not quite clear why it represents a significant problem.

Mr. FENDLY. I will tell you. Please allow me a few more minutes.

Senator SARBANES. Presumably, you would charge fees to compensate you for the work or the services you are rendering.

Mr. FENDLY. What is failed to be realized here is that a broker's fee also can be covered in the yield spread premium.

A simple analysis. If there was a $1,000 origination charge and a $1,000 yield spread premium on a transaction, and we aren't able to do this any more, the $2,000 will simply show up at origination. It is not going away. You have to make money. You have to cover the cost of business. You have to be able to do that. And that is one of the ways that the brokers utilize the yield spread premium, frequently for a borrower, frequently for part of their own fees. That is part of the process and it is the way that the real world operates.

Senator SARBANES. Would you say that a broker who charged a fee and then in addition, took the yield spread premium, but did not make it very clear and understandable to the borrower, that he could have, in effect, offset the fee with a yield spread premium, was behaving improperly?

Mr. FENDLY. Absolutely.

Senator SARBANES. Okay.

Mr. FENDLY. Absolutely. The problem—in recharacterization, this yield spread premium, if you will, is just a very simple example.

On a loan where the broker is operating totally on a yield spread premium of one point and no other fees to the broker, the new recharacterization would turn that compensation into direct compensation, give the yield spread premium to the borrower, which would mean you would now have to charge one point, okay?

When the borrower goes out into the marketplace to shop, the broker is going to look more expensive. But additionally, by turning that into direct compensation, it is now calculated into the annual

*Attachments held in Committee files.

percentage rate. Now, we have a higher annual percentage rate. We have a higher fee on paper for exactly the same loan, exactly the same cost, exactly the same terms. That doesn't accomplish any intended objective.

One last comment with what Mr. Acosta had to say with enforcement. We have talked about enforcement for a long time. I also was privy to the hearing that you held a little over a year ago on yield spread premiums. You had three borrowers in here that were abused terribly. The laws were broken. There was absolutely no doubt about it. They were violated. Current statutes were violated.

As of 4:00 yesterday afternoon, all three of those companies are still in business, despite numerous complaints today. And I find that absolutely atrocious.

Senator SARBANES. Mr. Rheingold.

Mr. RHEINGOLD. I am not sure where to start, maybe, the yield spread premiums.

Take a look at what HUD is offering here and why it makes sense. The HUD proposal basically says—and the broker industry wants it both ways—there is a disclosure up-front. We are going to charge you $3,000. We are going to charge you $2,000. We are going to charge you this amount of money.

Now, consumer, you choose how you want to pay us that compensation. They can still use a yield spread premium. The consumer can say, you know what, I will take the higher interest rate and you can get your yield spread premium and that is how you will be compensated that $3,000.

Or they can take half of it as an up-front fee and half of it in the form of a higher interest rate that will allow the broker to take the yield spread premium. Or the full amount could be paid up-front and they will get the lower interest rate.

It really is fairly simple and I am still not understanding why that is not fair. The broker up-front explains to the consumer what their compensation is and then the consumer has the opportunity to choose the method by which the broker gets paid—yield spread premium, part yield spread premium, or fee. That to me is so fundamentally fair and so fundamentally right, I fail to understand anything else.

As to the enforcement piece, I find it interesting that those three companies are still in business. As somebody who spent a lot of time trying to litigate cases against mortgage brokers and people who are doing yield spread premium stuff, of course they are still in place, because, in fact, it is almost impossible—because of what HUD did in 2001, taking away real enforcement as to the class action protection for people, there is no real enforcement of the yield spread premium violations that are going on today. There simply isn't. The fact is that trying to bring an action against a mortgage broker company is extremely difficult.

So, yes, we believe in private enforcement. We think that they need to reform it in a way that class action litigation can be brought against those companies that are engaging in these illegal practices.

Senator SARBANES. Good.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Reed.

COMMENTS OF SENATOR JACK REED

Senator REED. Thank you very much, Mr. Chairman. And thank you all for your testimony.

We seem to be circling around the same very important issues, so if I am a bit redundant, I apologize.

The whole premise here is that if the process is transparent to the consumer, they will make wise choices. The question is, how do you get transparency?

The current system does not provide that transparency. Would you agree with that, Mr. Fendly, in terms of yield spread premiums and in terms of how brokers are compensated?

Mr. FENDLY. I think it would be definitely improved. And again, the disclosure that we propose would do that.

Senator REED. Now, Mr. Rheingold, with respect to the disclosure that they have proposed, would you comment upon that?

Mr. RHEINGOLD. Actually, I cannot because I do not have it in front of me. But I would highly doubt that we would be in favor.

Senator REED. But the issue——

[Laughter.]

Senator SARBANES. No, you cannot say that.

Senator REED. We cannot say that.

[Laughter.]

Mr. RHEINGOLD. I have seen other proposals from the mortgage broker industry and if it is anything like what I have seen before, I do not remotely——

Senator REED. No comment, I think. That is a no comment.

[Laughter.]

Thank you. We usually do that, Mr. Rheingold. You cannot do that. We do that.

[Laughter.]

You have to actually look at the material before you comment.

[Laughter.]

So, we all agree that the disclosure now is inadequate and we have to do something. And the question is, what do we do?

It seems to me that to get at this problem, there is a couple of things that we can do. One is that we can improve the disclosure, and we are having a debate about whether the HUD proposal is an improvement or it is a retrograde. The other would be to prohibit the use of yield spread premiums to compensate brokers. That is a possibility.

Mr. Fendly, what would your position be on that?

Mr. FENDLY. Obviously, I would be in favor of that. It is used properly in a multitude of transactions, the high percentages of transactions. And I think a definite direct result of that would be a reduction in homeownership, specifically with first-time homebuyers and minorities.

Senator REED. A third way to get at, maybe not directly this problem, but to respond to some of the discussions. Ms. Saunders read some of the Internet postings about the broker's role. And there seems to be, as Mr. Rheingold said, that you want it both ways. You want to suggest to the homeowner or the prospective homeowner that you are working for that person. You are getting them the best rates. You are doing everything on their behalf.

And yet, when it comes down in certain cases, that there is not a proper disclosure, would it be appropriate—and I say this, and I am not being facetious, to require much more dramatic warnings to consumers that, in fact, you are not operating on their behalf, you are not out for them, you are not giving the best rates to them?

Mr. FENDLY. Actually, in our own disclosure that we used here, and I would just read a little piece of language to you, right up-front, we tell them, we cannot guarantee the lowest price or best terms available in the market. And we, as with all originators, may not offer all the products that are available in the marketplace.

Senator REED. I think that that would have to go, not just in your disclosure form, but in your advertising.

Mr. Rheingold.

Mr. RHEINGOLD. I think that is a good point. I think there is a real problem here because of what we are dealing with, and we have to look at the whole settlement process in total. What we have is a process where there are a lot of documents. Having another document that provides a disclosure that says, I am your agent, or I am not your agent, or I am an independent contractor, simply cannot mitigate what happens in that relationship.

I have never had a client who did not believe that the mortgage broker was their agent, despite a document that may be in the settlement package that says something very different.

Senator REED. Yes. Mr. Fendly.

Mr. FENDLY. Yes, if I could just comment. What we are looking for is something that is equitable and fair for all. I am aware of what I see on the Internet. Ms. Saunders is exactly correct. I can also pull up direct lenders on there that claim that they have the best rates, also. That is an issue that is in the marketplace. If it is fair for everybody, if it applies for everybody, I do not think we would have a problem with it.

Senator REED. Well, I go back to Mr. Rheingold's point because I think the perception of most people looking for a loan, when they go to a broker, is that the broker is working to get the best deal for them. It is their broker, even though a broker is a middleman, a classic middleman between the two sides of the transaction.

So, I think it goes back to the point that the disclosure forms, as you go through these different options, and I have exhausted my real of options, we have to go back to the first point, which is accurate transparent disclosure of the fees.

As I understand the proposal that HUD has suggested, is that disclosure is made up-front. The borrower can decide, given the knowledge of the yield spread premium, how that is going to be applied. Is that your understanding of the HUD proposal?

Mr. FENDLY. I think it is very flawed. As I explained earlier, it just simply makes mortgage brokers look terribly more expensive. I think that is a terrible price to pay.

Senator REED. One mortgage broker will try to get it cheaper than the other mortgage broker. That is the nature of the market, to get business.

Well, let me just change the subject for one last question. Mr. Acosta made a very important point about access to the minority community to loans for homeownership.

One of the things that strikes me is that it seems from some of the studies that have been done, that this allocation of yield spread premiums disadvantages low-income purchases much more than sophisticated high-income purchasers who have both perhaps the legal advice and also the time to delve into it. And so, by addressing the yield spread premium, we could on one end at least lower the costs or potentially lower the costs for low-income consumers. Is that your sense, Mr. Acosta?

Mr. ACOSTA. I believe that it is a lack of liquidity in our communities that has created the opportunity for predators to come into those markets and take advantage of consumers. That is something that we are very cognizant of when we try to make our policy.

We do understand the role that yield spread premiums have and we know they have been abused in the past. So disclosure is not an issue with us. What is an issue with us is an inequitable situation between competitors. We think that if you eliminate small business professionals from our communities, that will result in less homeownership opportunities for our consumers.

Senator REED. One more quick question, Mr. Chairman.

Mr. Courson, I presume that, as Mr. Acosta suggests in his testimony, to truly access the low-income communities, the Hispanic community, the African-American community, it helps very much to have Hispanic, African-American agents, whatever. Is that going to change in a business sense for mortgage bankers if these Rules are adopted? Are you suddenly going to be able to, because you can package these and you can squeeze out, of course, not have to use that wonderful resource to reach these consumers?

Mr. COURSON. I think that is accurate. Competition—the key is that we are talking about first-time homebuyer, minority homebuyer, those who are probably the most aggrieved today in the system we have of getting an estimate up-front, a shopping list of costs that they do not understand anyway, having no viability to what the real costs are in the end.

So to access that marketplace, I am going to say, here is the cash. They want to know how much cash do I have to bring? They are wonderful savers. They are wonderful family units.

How much cash do I have to bring to closing? That is the number they want. And then it is simple. Now rather than have to worry about 15 items on a statement they have to shop, they can call and know that it is a rock-solid guarantee, my cash versus my competitor's cash.

Senator REED. Thank you.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Crapo.

Senator CRAPO. Thank you, Mr. Chairman. I will withhold questions at this point.

Chairman SHELBY. Senator Carper.

COMMENTS OF SENATOR THOMAS R. CARPER

Senator CARPER. Thank you, Mr. Chairman.

To each of our witnesses, welcome. We are glad to see some of you again and to welcome others of you for the first time.

Mr. Chairman, I am struck by this panel. We have a lot of panels that come before us in our various Committees. Usually, you have

within a panel that is this large, you have some people who are just very thoughtful and some people who are very well-spoken. In this case, I think every witness here is thoughtful and well-spoken. And I have never seen a panel that has more diverse opinions or more at odds with one another.

[Laughter.]

I want to ask a couple of you to tell me, why do you think that is? I will start with Ms. Saunders. Why do we see such a sharp divergence of opinion here from, obviously, very thoughtful people?

Ms. SAUNDERS. I think that is a very interesting question. And if we were to go through the panel item by item, you would find more agreement than has perhaps been evident. For example, I think that many of us agree that the Good Faith Estimate disclosure, the third prong of the HUD proposal, should be appropriately tightened. And I think I heard that from Ms. Whatley and Mr. Acosta, and I know from Mr. Rheingold.

I am not quite sure where Mr. Courson is on that.

Senator CARPER. Let me see a show of hands. Is there anyone who disagrees with that premise?

[No response.]

Thank you. Go ahead.

Ms. SAUNDERS. All right. So on the yield spread premium part of the proposal, the discussion that Senator Sarbanes was leading, I think that Ms. Whatley agrees. I think that Mr. Acosta agrees. I am not quite sure. I know that Mr. Rheingold and I agree, and I think that Mr. Courson agrees. I do not mean to put words in anyone's mouth, but I am not quite sure what Mr. Kovaleski's position is on that. And I know Mr. Fendly doesn't agree.

Now on the guaranteed——

Senator CARPER. Will you stop again?

Ms. SAUNDERS. Yes, sure.

Senator CARPER. On that point, Mr. Acosta, Ms. Whatley, Mr. Rheingold, Mr. Courson, certain things have been attributed to you. Do you concur with Ms. Saunders' representation?

Mr. COURSON. On that issue.

Senator CARPER. All right. Fair enough.

[Laughter.]

Good. Please proceed.

Ms. SAUNDERS. Now, I think the second part of that issue which needs to be focused on, before I go on to the third, which is to improve the value of the yield spread premium regulation, Mr. Rheingold and I, I know agree that it must be put in a different part of the regulation so as to make it enforceable. But I do not know if anyone but Mr. Rheingold and I agree on that, it has not been a high-profile issue.

Senator CARPER. Does anyone at the table have a concern with putting in another portion of the proposal?

Mr. COURSON. Senator, we really have not explored that, so I would not want to represent the MBA position.

Senator CARPER. All right.

Ms. WHATLEY. Nor have we.

Senator CARPER. All right. Fair enough.

Ms. SAUNDERS. On the Guaranteed Mortgage Package, I think that is the issue that has clearly drawn the most fire, the consumer

groups, Mr. Rheingold, Mr. Courson, and I are all in general agreement that the idea is good. I think once you get much beyond that, we split off a little bit.

But we were, along with Mr. Fendly's predecessors, part of a long, ongoing effort at HUD to come up with a way of resolving the yield spread premium problem. And the Guaranteed Mortgage Package was the result of that joint effort.

The idea was that mortgage brokers did not want to have to tell anyone what their compensation, full compensation, would be. So the consumer groups said, okay. We do not care what your compensation is, so long as the consumer knows on the day that he is applying for the loan exactly what all the costs and the interest rate will be. We do not care if there is a payment, a kickback, as long as the consumer, before he plunks down any money, gets the value of his bargain.

Now what is somewhat misunderstood is the value to the consumer of all of these different closing services. Many of the services that the consumer gets in the closing of the loan have no value whatsoever to the consumer. The consumer—and in fact, the fact that the consumer pays for them is just because the lenders have figured out that they can get the consumer to pay.

The appraisal, the title insurance for the lender, very often the survey, certainly many of the other closing services, are all services and fees that are required by the lender and have no value to the consumer.

Consumers, in fact, make a mistake if they rely on a lender's appraisal as being of value to them to determine whether or not they have paid the right price for the home. They should get their own appraisal. And I think even appraisers will agree with that, that the appraisal done for the purpose of buying a home, is a different kind of analysis than the appraisal done for the purpose of getting a loan.

So on the Guaranteed Mortgage Package, I think that is where you are going to find the greatest degree of diversity, although Ms. Whatley and Mr. Acosta, I believe, said that if HUD were to simply say that volume-based discounts must be passed along to the borrower, I think we all agree with that point, that that might be a better, easier, less complex method of achieving much of the goals of the Guaranteed Mortgage Package. I do not mean to put words in anyone's mouth, but that is what I think I heard.

Senator CARPER. Well, I wish we had time to get a reaction to that last comment, but my time has expired, and I thank you for your observations. It is nice to have witnesses who are interested in looking for common ground, as opposed to just looking at the differences.

Thank you.

Chairman SHELBY. Thank you, Senator.

Mr. Fendly, in your testimony, you say that the Rule proposes to change the way mortgage brokered compensation is characterized, and that the result in impact would be that a loan from a broker—we talked about it already here, but again—appear to be more expensive. Why do you think that HUD thought that this was necessary? Don't brokers already disclose their fees? Why don't other originators of loans have to disclose their fees?

Mr. FENDLY. Obviously, mortgage brokers do disclose their fees. We have already discussed that a better Good Faith Estimate would be of value in the process.

The recharacterizations that I explained earlier clearly turns this playing field upside down and makes us appear more expensive for the exact same loan, exact same costs, when compared with a mortgage lender. I do not consider that to be a solution.

What I find interesting is, I have been both a mortgage banker and a mortgage broker. I have been in this industry 20 years and I understand how both sides of this industry work.

I have rate sheets with me that I find very, very interesting that are put out by retail direct lenders that include overages that they give to their loan officers that show them how much they will get for a higher rate. It is no different on both sides of the coin. We are not necessarily advocating that that go away. All we are advocating is we need an equal, level, equitable playing field that doesn't place us at a disadvantage.

I do not think anybody will disagree with the fact, if you must appear more expensive on an identical product with your competition, you are not going to get the business.

Chairman SHELBY. Okay. On a final note here, it is these kinds of disclosures and competitiveness issues that we have discussed that I believe must be thoughtfully addressed in light of the importance of our real estate market to the economy, billions of dollars. It continues to be my interest that HUD proceed prudently and in a way that allows these concerns to be openly addressed.

I think the Secretary has some good ideas here. I think it is in some of the details that causes some concern. And I believe that this could be best addressed by a revised economic analysis as part of a revised Proposed Rule.

Again, I want to mention that the Federal Trade Commission has commented that the current HUD proposal on broker disclosure could actually cause confusion and harm the consumer. We have to work this out. I hope the Secretary will do it with us.

Do you have a comment, Ms. Whatley?

Ms. WHATLEY. Mr. Chairman, responding back to Ms. Saunders, real estate has sustained this economy the last couple of years. And the fact that she has highlighted fairly succinctly that all of us sitting at this table believe that the Good Faith Estimate modified might resolve some of the solutions, I would hope that you as Senators might send back to HUD that taking that as a proposed first step, to look at something, might be the appropriate approach.

We fear that taking and trying to implement all of this at one time could be extremely disruptive to the industry and to the consumer. And I would hope that if we were all in agreement that the Good Faith Estimate was an appropriate approach, that HUD might work on that first and see if that did not resolve the concerns that they have, and ultimately achieve their goals.

Chairman SHELBY. I am going to reiterate that full disclosure is very important to me, and I think to most consumers and most Americans.

I have a little queasy feeling when you start talking about kickbacks or creating an opportunity for kickbacks. Those two things are deeply troubling.

But I want to work, and I know that the Committee as a whole wants to work with the Secretary to have a Rule that works for everybody. We will see what we can come up with.

Senator Carper.

Senator CARPER. Could I ask just a couple of quick questions of Mr. Courson, please?

Chairman SHELBY. Surely.

Senator CARPER. Thank you again, all of you, for being here and helping us to address an issue that actually enters into the lives of most Americans, not once, but any number of times.

Mr. Courson, first, what do you see as the major advantages for consumers of the Guaranteed Mortgage Package? And second, do you have any I guess consumer research that indicates that consumers really want this kind of option?

Mr. COURSON. Thank you for the question, Senator. Let me just answer the second question first, if I may.

There has been research done. We have done focus groups at the Mortgage Bankers Association over the last 2 or 3 years. I believe I am correct in saying that the Federal Reserve did a study also that talked to consumers. And those surveys show that, as important as the survey is, what I see in the customers that come into one of our retail branch offices, and one alone, is that they want that certainty, they want simplification, and that is what the package brings.

In due respect to those who are talking about a good faith, they want a guarantee. They want a number. They want to know how much cash to bring to closing.

Frankly, I think that there may be a question on the Good Faith Estimate as it is proposed in the Rule in terms of HUD's authority to do the Good Faith Estimate under the RESPA statute.

So, we may have to come to the Hill, as opposed to regulatory, if you were going to proceed in that fashion.

Again, while we go through all of that, and we have been, as Ms. Saunders said, we have been at this for 6 years, and many of us have become, although we have different positions, we have become also associates and friends.

Meanwhile, what happens, the consumer waits. The consumer waits for the certainty. And we would urge and have urged HUD in our comments, let's see if the marketplace works. Let's let the package work. Let's see if consumers want what research says and what we think they want, but at the same time, keep a system that lets us do business, by retaining the Good Faith Estimate with the yield spread disclosure, very specifically, as opposed to the way it is today.

Senator CARPER. Thanks, Mr. Courson.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Sarbanes.

Senator SARBANES. Can I pursue this?

Chairman SHELBY. Certainly.

Senator SARBANES. All these providers are asserting that if you do the Guaranteed Mortgage Package, we are going to "drive small business out." That is what Congressman Manzullo came over here to testify to this morning. And that it will then be concentrated all in the hands of the lender, would totally dominate the field. And

that once they do that, then they will turn on the consumer and stick the consumer with high fees and charges. So, in the end, the consumer will end up being the loser. Am I putting that——

Mr. KOVALESKI. I think that is right. I think the example that Senator——

Senator SARBANES. Now what is your response to that?

Mr. COURSON. Senator, if I may respond. We have to understand that, today in business, and those of us who are in business, there are big lenders, medium-size lenders, and small lenders today. And I have been around this business too long, 40 years, and that has always been the case. There are large, medium, and small settlement service providers.

I have always been part of a small- or a medium-sized company. And I have competed against large lenders and financial institutions that have more capital, lower cost of funds, better technology, more resources, but I compete.

I think that the key is that, in this particular case, frankly, many of them can offer things that I cannot offer because of their wherewithal inside their corporate environment.

The Rule under the Guaranteed Fee Agreement allows me the ability to go out and now compete, to negotiate the types of things that they can do with their own subsidiaries or affiliated businesses, to be able to compete at the street level.

Because we have to remember, we talk about large lenders. Large lenders really are aggregated. Mr. Fendly and I will tell you that over 60 percent of the loans that are originated are originated by small- or medium-size originators.

And so, on the street level, we are still going to be there. We have been there 40 years. There were big banks—not the same banks that are around today—40 years ago, but there were big banks then, and we got loans, and there are going to be big banks around. But what they are doing is relying on us to originate their loans so they can aggregate them into large pools and service them.

So, we are going to be the ones on the street. And real estate is local. When I get a loan transaction, the title company, the title agent, the escrow company is selected in most cases when the purchase transaction takes place. It is brought to me. That is not going to change. When I do business in one of the small towns, that is the way that business is still going to come to me.

Now that cost will be part—I will have to talk to that group—of the guarantee that I give the customer. But my business relationships are the same. I cannot close loans from California in Alabama, where we have offices. And so, we do it with local closing attorneys, local title companies.

Chairman SHELBY. Anything else?

Ms. Whatley.

Ms. WHATLEY. Senator, I think I recall when Congressman Manzullo held his hearing, that the Colorado small bankers and lenders actually were opposed to the Guaranteed Mortgage Package. They felt like their ability to compete with some of the smaller service providers would actually hamper their ability to compete against the larger lenders.

So, I think that is why you see some real difference, philosophical differences about what is the impact of going to a Guaran-

teed Mortgage Package where, under its current proposal, there is no transparency. And part of the challenge for HUD is that they are unable to communicate back to us to say, here is what we are thinking. Here is where we might be going. Here is what we might be putting in.

All they can do is hear from us. They cannot respond to us, which is why I think it is critical that they would actually put out a new Proposed Rule that all of us at this table could look at and say, that might possibly respond to some of these concerns that we have in this particular area, or, no, we still think you are very far off-base in this area. But you might get a better sense, because you can tell that there are true philosophical differences on some of these key points across the industry. When that happens, it tends to not be in the best interests of the consumer.

Chairman SHELBY. Why would someone be against disclosure even in a packaging operation?

Ms. WHATLEY. I cannot think of a reason.

Chairman SHELBY. Mr. Acosta.

Mr. ACOSTA. I cannot think of a reason, either.

Chairman SHELBY. You cannot think of a good reason, anyway. [Laughter.]

Mr. ACOSTA. I cannot think of a good reason, that is right. I think that I want to agree with Ms. Whatley's comments earlier with regards to the Good Faith Estimate. But I want to add to that that it is not just a matter of modifying it. It is also a matter of putting some teeth to it, holding the lenders accountable for what they put on paper.

I agree with Mr. Rheingold when he says that the lenders know what those fees are going to be, generally. I agree with that completely. There are cases when things change, but I do think that we can put some safeguards in to protect the consumers from abuse in that regard.

I think the spirit of everything that we have heard today, and I think that we are all in agreement here, it is all about disclosure and it is all about accountability. And I think we all agree that both of those things are good.

The question I have is why is there one member of this panel here that is not accountable? Why do the mortgage bankers, why are they the only ones at this table that are not accountable with regards to disclosure?

Chairman SHELBY. Well, that is inexplicable.

Mr. ACOSTA. That is the problem that we have. I am also questioning why the consumer groups here do not let them off the hook. Let's put it that way. Why all the energy is focused at the broker community and the small business professionals and not the major players? That is the question that I have.

Chairman SHELBY. Go ahead, Ms. Saunders.

Ms. SAUNDERS. May I briefly respond? I want to explain two things. One is we like the idea, in answer to the question why we are letting the mortgage bankers off the hook, which I haven't been accused of doing very often.

[Laughter.]

Senator SARBANES. If ever.

[Laughter.]

Chairman SHELBY. Don't let anybody off the hook.

[Laughter.]

Ms. SAUNDERS. And we like the idea of simplifying the mortgage process.

Chairman SHELBY. So do we.

Ms. SAUNDERS. That is why we like the idea of the Guaranteed Mortgage Package. In fact, many consumer groups take credit for the original idea, although it was originally proposed in the context of statutory reform of RESPA and Truth in Lending and a lot else was supposed to accompany it.

But we also need to add our concern to yours, Mr. Chairman, about the lack of disclosure. Not only are we losing transparency, but also if the mortgage package goes through as proposed by HUD at this point, regulators and consumers will be unable to determine current compliance with Truth in Lending and the Home Ownership and Equity Protection Acts.

So while we like the general idea of the package, disclosure is essential to maintain the enforcement of another very important consumer protection act, the Truth in Lending Act.

Chairman SHELBY. Thank you all for appearing here today.

The hearing is adjourned.

[Whereupon, at 12:20 p.m., the hearing was adjourned.]

[Prepared statements, response to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF SENATOR DEBBIE STABENOW

Chairman Shelby, thank you for calling this second hearing looking at HUD's proposed reforms to the Real Estate Settlement Procedures Act. I know that the proposal HUD has been working on is of great importance to consumers, as well as those involved in the lending process; this oversight hearing provides an opportunity to examine carefully the likely impacts of the proposal.

I have argued for quite some time that consumers need more certainty and more transparency in the homebuying process. Any sound and balanced effort that accomplishes these goals is one to which I could lend my support.

Buying a home is the single most complicated financial transaction that most Americans will ever undertake. It can be extremely confusing and consumers often have a difficult time shopping for different loan products. Even people who consider themselves relatively financially-savvy can get bogged down in the process.

Mr. Chairman, one of the things that I am particularly glad to see is that there is interest in addressing the shortcomings of the Good Faith Estimate. As you know, there are no penalties if the GFE is grossly inaccurate and, in some cases, it is of only very limited use to homebuyers. We would do the public a great service if they had more concrete information prior to closing about how much they need to bring to the table.

I also see promise in the idea of a Guaranteed Mortgage Package. I believe that a guarantee makes a lot of sense as long as these packages have uniformity and can be easily compared.

I welcome our witnesses today. I know that several of them have serious concerns about HUD's proposal. I am anxious to learn more about what they have to say and I hope that HUD is listening closely to their concerns.

It is important that as we proceed with this reform process, that we balance a number of concerns. We should ask ourselves: How can we promote competition in the homebuying process? How can we look out for small businesses involved in the lending process and ensure that they can compete fairly? What steps should be taken to protect potentially more vulnerable borrowers in the subprime markets? And how can we eliminate the confusing aspects of this process and enhance transparency and certainty?

Therefore, with all of this in mind, I believe that all concerned parties, working together, could ultimately come up with a reform proposal that would have widespread support. Thank you.

PREPARED STATEMENT OF SENATOR JACK REED

Secretary Mel Martinez should be commended for his effort to streamline the homebuying process. If implemented correctly, the Proposed Rule reforming the Real Estate Settlement Procedures Act (RESPA) regulations could help make the homebuying process both easier to understand and less expensive.

As the Secretary has been learning during the rulemaking process, this Rule means real change in the real estate industry, and as such, it has created much controversy. However, I think there is much good the Final Rule might accomplish if it includes the following points.

First, according to a recent study by Freddie Mac and HUD's own analysis, 50 cents of every yield spread premium dollar does not go for closing costs, and this practice must stop. Yield spread premiums, the difference between the underlying interest rate of the loan and the rate charged to the consumer, are for closing costs and should not be used for anything else. Any other purpose should be classified as an illegal referral under RESPA law.

Second, the proposed Guaranteed Mortgage Package (GMP) should be limited to the prime market only. The exemptions provided by the Proposed Rule would make it too easy for subprime lenders to engage in predatory practices, which this Committee has been working very hard to prevent. I believe HUD can ensure that GMP's are only offered in the prime market and should do so.

Finally, I believe HUD does not have, nor will it ever have, sufficient resources to patrol every real estate transaction. Therefore, HUD's regulations need to include stiffer penalties for breaking the rules, such as a private right of action for the consumers.

I appreciate the time and thought today's witnesses are giving to this important issue, and I look forward to working with them to ensure that HUD considers their viewpoints while formulating a Final Rule. If done appropriately, I believe the proposed reforms would help more Americans achieve the dream of homeownership.

PREPARED STATEMENT OF SENATOR ELIZABETH DOLE

Mr. Chairman, I would like to express my appreciation to you and to Ranking Member Sarbanes for agreeing to hold this hearing on the impact of the Proposed RESPA Rule on small businesses and consumers. While this Proposed Rule seeks to make it easier for consumers to compare prices and to get the best loan possible, some believe that the Proposed Rule could harm the smaller businesses in the mortgage industry.

Increasing homeownership, especially for lower income and minority families, is one of my top priorities. Families who own their own homes are more involved in their communities; they build wealth; their children do better in school; and they are all better equipped to climb the economic ladder of success. Unfortunately, the current costs and complexities of the mortgage settlement process have created a barrier to homeownership for many Americans. Efforts to create greater opportunities for homeownership should include an initiative to simplify and lower the costs of the mortgage settlement process.

In recent weeks my office has heard from a number of smaller North Carolina businesses in the mortgage industry who are very concerned about how this Proposed Rule may affect consumers and the industry. They believe that in their effort to give consumers more options, greater transparency, and lower costs, HUD may actually be accomplishing the exact opposite. Unfortunately, the mortgage settlement process is very complex, making it difficult to fully grasp the potential impact of this initiative.

I want to thank Secretary Martinez for joining us here on March 20, to discuss these issues. One point he was very clear on was his willingness to work with all parties concerned on this Proposed Rule. In addition, he was clear that all views would be taken into consideration before a Final Rule is contemplated.

I hope that this hearing allows all of us to gain a better understanding of how this new RESPA proposal will affect our housing and mortgage markets as we work together to ensure that more Americans can realize the dream of homeownership.

Thank you.

PREPARED STATEMENT OF DONALD A. MANZULLO

A U.S. Representative in Congress from the State of Illinois
Chairman, House Committee on Small Business

April 8, 2003

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, thank you for inviting me to testify on the effects on the small business community of the Department of Housing and Urban Development's (HUD) proposal to revise the regulations implementing the Real Estate Settlement Procedures Act (RESPA). I come before you today not just as the Chairman of the House Small Business Committee but also as a Member of the House Financial Services Committee. In addition, prior to being elected to Congress, I was an attorney in private practice for 22 years and I have personally closed more than 1,000 real estate transactions.

The question before us today could be, "Why is HUD taking a position that essentially legitimizes kickbacks to large lenders that enter into agreements with settlement service providers and allow those relationships to be hidden from consumers?" The proposal should focus on better disclosure of the various settlement fees so that consumers are fully advised of all of the fees going into a settlement transaction rather than permitting large mortgage lenders to hide their fees charged to consumers and the monies received from settlement providers.

I fully support simplifying and clarifying the settlement process so that more first-time homebuyers can enter the market, however, I believe that HUD's RESPA proposal will make fundamental, and most likely, irreversible changes to our residential real estate market. In the short-term, the proposal may jeopardize our robust real estate market. In the long-term, the proposed changes may undermine the goals of providing affordable housing and enhanced protections for consumers. In my opinion, the proposal is bad for small business and it is bad for consumers.

On March 11, I chaired a hearing of the House Small Business Committee to hear testimony from Secretary Martinez and the small business community on the impact of the proposal on small entities. The hearing was a bipartisan effort with Members of both sides of the aisle expressing strong concerns about the proposal, including Ranking Member Nydia Velazquez who also wrote a comment letter to

HUD about her concerns. Several of the Members, including Ms. Velazquez, are Members of the House Financial Services Committee and several other Members have had broad experience with real estate transactions prior to being elected to Congress.

In addition, there are bipartisan Members of the House Financial Services Committee who share our concerns. Congressman Mel Watt of North Carolina is a Democratic Member of the Financial Services Committee. We have very similar backgrounds and were elected to Congress the same year. The Congressman and I have the same view of the RESPA proposal and believe that it would significantly harm our real estate market.

While the small business community has many concerns about HUD's RESPA proposal, the two primary concerns are that the proposal is tilted unfairly toward the mortgage lending community and against small business real estate professionals and that HUD did not fulfill its obligations pursuant to the Regulatory Flexibility Act to demonstrate the anticipated burdens to be faced by the small businesses.

The overwhelming majority of the small business community that have contacted the Committee, including virtually all of the small settlement providers and a significant proportion of the community banks, believes that the proposal would unfairly give significant power to the mortgage lending community, especially large lenders, to put together Guaranteed Mortgage Packages. HUD's proposal would permit mortgage lenders to determine what real estate settlement professionals may participate as a part of a package, to negotiate "bulk pricing" with the settlement providers, and to minimize the disclosure requirements to consumers on the costs of the package contents.

In addition, packagers would be allowed a safe harbor from liability under Section 8 to permit payments between package participants without any disclosure to the consumer. Small businesses, that are unable to participate in package arrangements, must attempt to compete using the detailed itemized listings under the proposed Good Faith Estimate reforms. Those small businesses also would be ineligible for safe harbor relief.

A significant fear is that large mortgage lenders may use the package of settlement services as a "loss leader" in order to obtain the more lucrative servicing and secondary market fees associated with the administration of a residential real estate loan. Once competition in the marketplace is reduced, the packagers may attempt to bulk price other products, services, and items for the purchase of a home.

For example, a lender may suggest that all homes built prior to 1990 must be installed with energy efficient windows. The lender may have entered into a bulk pricing agreement with the window manufacturer for the windows and a contractor to install the windows. If faced with such a situation, a consumer may be unable to discern whether being able to obtain a settlement and loan package is predicated upon other packages being offered by the lender. If competition for lending is reduced, some consumers may find it unclear as to how many financing alternatives the consumers really has and what may be necessary to secure a loan.

So in October 2002, the Administration, through the Office of Management and Budget, undertook a Government-wide initiative to end all Federal agencies from bundling Federal contracts to large businesses. The Administration believes that contract bundling is not good for our economy as it reduces long-term competition in the marketplace.

HUD appears to be taking the opposite position with the Guaranteed Mortgage Package Agreements. According to the *American Banker,* the top 10 mortgage originators account for more than 53 percent of the industry. With Guaranteed Mortgage Package Agreements, it is anticipated that that figure will climb quickly. In my opinion, HUD needs to further explore the long-term economic ramifications of its proposal prior to adopting Guaranteed Mortgage Package Agreements with a safe harbor from Section 8 liability.

With regard to its economic analysis conducted pursuant to the Regulatory Flexibility Act and Executive Order 12866, HUD acknowledged that the proposal would place a $9.4 billion burden on small businesses. Of this $9.4 billion figure, $3.5 billion comes from the revised Good Faith Estimate proposal and $5.9 billion comes from the initiative to allow the packaging of settlement services. However, HUD does not break down the costs in its economic analysis for each segment of the industry.

HUD did not provide a detailed economic analysis for the community banks—small realtors—small title agencies—small appraisers—small pest management companies, just to name a few among the many other small businesses not specified in the analysis. It also should be noted that the economic analysis does not contain

any analysis of the additional 2.5 million hour burden that HUD disclosed in its Paperwork Reduction Act filing with the Office of Management and Budget. The $9.4 billion burden may, in fact, be significantly higher.

In addition, on pages 73 through 75 of the Regulatory Flexibility Analysis, HUD insists that small loan originators and small third-party service providers can compete effectively against large lenders and service providers in packing settlement services. Unfortunately, HUD offers no economic analysis to support such claims. Without such analysis it was extremely difficult for small businesses to comment on that section of the proposal.

In fact, HUD was so deficient in its small business regulatory economic analysis that the Federal Government's small business watchdog, the Office of Advocacy of the Small Business Administration, requested that HUD issue a supplemental regulatory analysis in order ". . . to provide small businesses with sufficient information to determine what impact, if any, the particular proposal will have on [the small businesses'] operations."

HUD added even more confusion to the RESPA proposal by asking 30 specific questions that would have been more appropriate as part of an Advanced Notice of Proposed Rulemaking. The questions were designed to elicit detailed concerns on how the Good Faith Estimate and the Guaranteed Mortgage Package Agreements should be implemented. However, it was unclear as to whether the answers to the questions would be made part of any Final RESPA Rule.

For example, question 22 on the Guaranteed Mortgage Package Agreement proposal requests whether State laws that are inconsistent with the proposed package arrangements should be preempted. Without knowing whether HUD intends to include State law preemption in the Final Rule, it is extremely difficult for small businesses to adequately comment on the regulatory burdens of the proposal.

Congress passed RESPA in 1974 with the intention of providing greater clarity to the homebuying settlement process for consumers. Congress passed the Regulatory Flexibility Act in 1980 with the intention of providing greater clarity to Federal regulatory process for small businesses. Ironically, the question before us is whether HUD, in its efforts to improve the clarity in the homebuying process for consumers, has provided the adequate and necessary disclosures to small businesses for clarity in the Federal regulatory process. I believe that HUD has not.

In the same way that HUD proposes to require the real estate industry to put forth a firm Good Faith Estimate to consumers on the costs of settlement, the Regulatory Flexibility Act requires Federal agencies to put forth a "Good Faith Estimate" known as an Initial Regulatory Flexibility Analysis to let small businesses know the cost of regulations up-front. In either case, there should be no surprise costs or added charges by the time a real estate settlement reaches the table or by the time an agency's final regulation reaches the table.

Originally, I had believed that HUD, at a minimum, should issue a supplemental Regulatory Flexibility Analysis to clarify the exact burdens to be faced by small business. However, after careful consideration, I do not believe that this would answer the many questions of the proposal being asked by small businesses. In addition, I do not believe that HUD can cure the deficiencies in the Final Rule as it would deprive small businesses the ability to comment on any major revisions or changes in economic assumptions. I strongly believe that HUD should issue a revised proposed rulemaking incorporating the answers to the pertinent questions and seek public comment.

If HUD does finalize its Proposed Rule, HUD may find itself in an uphill battle in the court system. I believe that small businesses have a legitimate claim to set aside the Rule until a sufficient small business economic analysis is conducted. I am not sure why HUD is risking the uncertainty that will be caused by the litigation or the thousands of hours and dollars to be spent defending such a legal challenge.

Before we tinker with the successful formula that has created our very strong residential real estate market, we should carefully and deliberately consider the reform proposals before us. Rushing to finalize the proposal may cause unintended, and perhaps, irreversible harm to competition in residential real estate market and prevent us from achieving meaningful consumer benefits.

Just as HUD does not want consumers to face surprises at the real estate settlement table, HUD should not provide surprises to the small business community and consumers in a Final RESPA Rule and its Final Regulatory Flexibility Analysis. I strongly believe that the proposal, as drafted, is bad for small businesses and it is bad for consumers.

PREPARED STATEMENT OF CHARLES J. KOVALESKI

PRESIDENT-ELECT, AMERICAN LAND TITLE ASSOCIATION

APRIL 8, 2003

My name is Charles Kovaleski and I am the President of Attorneys' Title Insurance located in Orlando, Florida. I am appearing today as President-Elect of the American Land Title Association,[1] which represents both title insurance companies and over 1,750 title insurance agents, most of which are small businesses. With me today is Ann vom Eigen, ALTA's Legislative and Regulatory Counsel.

ALTA, and I personally, would like to thank the Chairman for holding these hearings. The HUD proposals may not only have a very significant and adverse impact on our industry, on our customers, and our insureds. They could also have a very negative impact on what has been the one healthy area of the American economy in recent years—the residential real estate market.

RESPA is the guiding Federal regulatory program for our industry. It affects the activities of our industry, our relationships with our customers, and our relationships with lenders, real estate brokers, and other settlement service providers. Indeed, no other Federal statute or regulatory program has such a pervasive impact on how we do business and how we compete for business. Accordingly, ALTA and its members have been deeply involved in RESPA issues since Congress debated its enactment in the early 1970's. Over the years, we have participated extensively in every legislative and HUD regulatory forum to ensure that the RESPA Rules serve the interests of consumers while providing fair and reasonable Rules from the standpoint of our members.

We understand the concerns that may have prompted the HUD proposed regulations that were published in July 2002, and believe that the Secretary and the Department deserve credit for the boldness of their initiative. However, our Association and its members are deeply concerned about how these proposals, if promulgated in final form, will impact our customers, our industry, and the real estate and mortgage lending markets throughout the country. Accordingly, we filed detailed comments on the Proposed Rule with HUD in its rulemaking proceeding. We also participated in an SBA roundtable on the effect of the proposal on small businesses.

What I would like to do today is highlight why we believe the proposals do not serve the interests of the consumers of our products and services, and why they would adversely affect competition in our business, particularly hurting small businesses that are the cornerstone of our industry. Please note that the Proposed Rule is likely to have such a dramatic effect on our industry that the ALTA board has authorized the Association to explore litigation should a Final Rule be substantially similar to the Proposed Rule. I will highlight an alternative we have recommended to HUD that would achieve many of the Agency's objectives while minimizing consumer and industry problems. We urge the Committee to ask HUD to seriously consider these alternatives.

HUD Should Proceed Slowly

We, as well as other groups affected by the proposed regulations, are concerned that any reforms along the lines proposed by HUD—or even our own two-package alternative—which would so radically affect the mortgage lending and settlement services markets throughout the United States, should not be undertaken without appropriate statutory authorization.

The revised GFE and packaging regimes constitute complex and far-ranging regulatory superstructures for which the only statutory foundation is a single sentence in Section 5(c) of RESPA, enacted in the RESPA amendments adopted 1 year after the original statute was enacted, that requires a mortgage lender, within three business days of receiving a loan application, to provide to the applicant a "Good Faith Estimate of the amount or range of charges for specific settlement services the borrower is likely to incur." That slim statutory foundation will not support such weighty regulatory measures as HUD is proposing, no matter how well-intentioned they may be. Moreover, the original RESPA statute contained provisions for the kind of firm estimates of closing costs that HUD has proposed, but these provisions were repealed in the 1975 amendments in which the "Good Faith Estimate" lan-

[1] The American Land Title Association membership is composed of 2,300 title insurance companies, their agents, independent abstracters, and attorneys who search, examine, and insure land titles to protect owners and mortgage lenders against losses from defects in titles. Many of these companies also provide additional real estate information services, such as tax search, flood certification, tax filing, and credit reporting services. These firms and individuals employ nearly 100,000 individuals and operate in every county in the country.

guage was adopted. We believe that, irrespective of whether one believes that the HUD proposals are good or bad, or workable or unworkable, this Committee and the Congress should be concerned about HUD's implementing such changes without clear legislative authority.

First, there is a very significant question of public policy at issue here—whether modifications of such proportion that will so fundamentally affect a major segment of the American economy should be implemented without legislative direction and authorization.

Second, the HUD regulations could well be challenged in the courts and the legal uncertainty regarding whether they will be upheld or struck down will, by itself, cause significant disruption in the real estate and mortgage lending markets. I have enclosed, as appendices to our testimony, not only our comments to HUD on the Proposed Rule, but a legal memorandum describing the legal issues. The HUD proposals, if adopted, will require massive and costly efforts by all parties in the residential real estate and mortgage lending industries to restructure their business arrangements, modify their forms and software, retrain personnel, etc. Much of that effort and costs to accommodate to the new regulations would be rendered useless if, after the regulations are promulgated in final form, the courts find—as our lawyers tell us is likely—that the regulations are unauthorized and cannot be enforced. Many Federal agencies, faced with this type of situation issue reproposed rules. This process would allow the Agency to address concerns expressed in comments on the original rule, modify their original proposal, and allow industries and affected parties to further analyze a revised proposal. This would provide substantial benefits.

In short, this is not an issue where we—or the Congress—can afford to say "let's see how the courts come out on this." Our members and the real estate and mortgage markets need greater certainty that any final regulations adopted by HUD will not be found to be unauthorized. We urge this Committee and the Congress not to allow such uncertainty to be created.

The Impact on Consumers of Title Insurance and Title-Related Services

Under the current RESPA statute and regulations, lenders must provide consumers, within three business days of receiving an application, a "Good Faith Estimate" of the closing costs the borrower "is likely to incur" in connection with the transaction. HUD is proposing to replace that regime with two alternative new regimes. The first, which is a revision of the current GFE regime, would require lenders to give less detailed estimates by category of costs, with limited or no tolerances for the accuracy of those estimates. The second regime would encourage mortgage lenders to offer what HUD refers to as a Guaranteed Mortgage Package—which would contain essentially all of the loan and other real estate-related settlement charges at a single guaranteed price, together with a loan at a guaranteed interest rate.

It appears to us that these proposals were developed with the refinance market in mind. However, it is clear that the two regimes would pose problems for consumers in purchase/sale transactions where the current homeowner is not merely refinancing an existing loan. The proposals are based on the faulty proposition that whatever services are needed by, and are good enough for the lender, will also meet the needs of the consumer. This may well be true in refinance transactions, where the settlement services obtained by the lender are intended solely to protect the lender's interest, and the borrower cares only about the total charges he or she may have to pay to obtain the loan. But it is not true in purchase/sale transactions, where the buyer and the seller have their own interests in the nature and quality of the title and closing services that are provided with regard to the conveyance of title from the seller to the buyer. HUD's proposals, particularly the GMP proposal, do not take those interests into account.

For example, the HUD proposals do not require the lender to specify what title-related services are included in the revised GFE estimate or in the GMP price, or how much of the GFE estimate or GMP price is attributable to those services. Accordingly, if the lender has decided to accept a reduced form of title protection because it believes the additional profit it will realize on the GMP as a result of the cost savings will offset the additional risk it is taking, the buyer/borrower may not appreciate that the protection the lender has decided to accept on the mortgage loan may not meet the buyer's needs with regard to the purchase transaction.

Second, because the consumer will not know what services at what costs are included in the GFE or in the GMP price, it may be impossible for the consumer to do an apples-to-apples comparison of offers from different lenders.

Third, the buyer and the seller may have agreed on the selection of the provider of certain title or closing services (such as the escrow company in States where escrow closings are customary, or a title company that will provide the title and closing services) in connection with the execution of the purchase contract and before

the buyer has begun to shop for a mortgage loan. In these situations, the price of the GMP package will also include those services and the borrower could end up paying twice for the same service.

Finally, in most areas of the country the seller generally pays half of the costs for the handling of the closing and will pay for all or a significant portion of the title insurance charges for the owner's policy. In addition, it is customary in most areas for the seller to pay for the governmental charges relating to the recording of the deed (with the buyer paying the charges for the mortgage). The GMP proposal, which assumes that the buyer/borrower pays for all closing costs, completely fails to reflect these widespread seller-pay practices.

The Impact on the Title Industry and Small Businesses in the Industry

The HUD proposals tilt heavily in favor of the packaging alternative, because packagers are provided an exemption from RESPA Section 8 for any discounts or things of value they may receive in connection with the selection of service providers for their packages. Because a mortgage loan at a guaranteed interest rate must be part of any GMP, everyone recognizes that only lenders will effectively be able to offer packages under the HUD proposal. Accordingly, title companies and other providers of settlement services will be placed in a position where they will effectively be deprived of market access to consumers and will only be able to effectively compete by becoming part of a lender's package. This will have adverse consequences for all ALTA members, but particularly for our small business members.

Major lenders will, of course, be aware that inclusion in their GMP's may be the only effective means by which providers of title and closing services will be able to obtain any significant amount of business in residential mortgage loan transactions—or, indeed, to survive. Moreover, HUD has structured its GMP proposal in a way that mortgage lenders are in a position to realize greater profits on their GMP prices by negotiating lower prices from the providers of the services in the package. The combination of these two factors means that providers of title/closing services will face enormous economic pressure to offer cut-rate prices and/or cut-rate services in order to be selected for inclusion in lender-created GMP's.

The backbone of our industry—the smaller abstractors and title agencies—will not have the resources to be able to offer substantial discounts. Based on a survey conducted by ALTA in 2002, which was a boom year for the real estate industry, 51 percent of the title insurance agents and abstractors in the country had less than $500,000 in gross revenue in 2001, and 72 percent had less than $1 million. Sixty-eight percent had 10 or fewer employees, and 42 percent had less than 5. These individuals and companies have demonstrated that they can effectively compete with anyone for the consumer's business, but in a world in which major lenders are able to use the clout derived from the volume of transactions they handle to extract discounts from major providers, these small businesses will simply be unable to compete on that basis. Equally important, we believe that the proposals, if implemented in their present form, would effectively close the door to future entry into this business by small businesses.

Second, while HUD maintains that "anyone can provide packages" under its proposed Guaranteed Mortgage Package regime, because the GMP Agreement offered to consumers must include a loan at a guaranteed interest rate it is highly unlikely that anyone other than lenders will be in a position to effectively offer GMPA's. The mortgage lending industry has become increasingly concentrated. In the last 5 years the top 10 mortgage originators have doubled their market share from 25 percent to 50 percent.[2] The HUD packaging proposal will also have the effect of increasing the concentration in the title and settlement services industry.

It is clear that HUD is aware of the potential negative consequences of their proposals, but believes that the adverse impact on small business is outweighed by: (a) the likelihood that major lenders will be able to obtain deep discounts from major settlement service companies who will want to be part of their packages, and (b) the prospect that mortgage lenders will pass through to their borrowers the benefits of such discounts. HUD estimates that small businesses will lose somewhere between $3.5 billion and $5.9 billion in annual revenues if their proposals are implemented. Whether these estimates are accurate—or too low—is not the critical issue. The critical issues are:

- What assurances are there that lenders will pass any savings along to consumers?
- Why is HUD so willing to tilt the playing field in favor of large lenders and large providers?

[2] "Consortium Approach Gains in Home Loans," *American Banker,* July 12, 2002, at 1, 10.

- Why is HUD so cavalier about the adverse impact on small businesses, which have been a mainstay of this industry?

We have been unable to get answers on these questions from HUD, but we hope you will.

If the packaging regime becomes widespread, as is likely to happen because it has the backing of the major mortgage lenders in the country, providers of title and settlement services will only be able to market their services to and through lenders. Lawyers and title companies that today are able to obtain business by direct contacts with the consumer will be faced with the situation where the lender, and only the lender, decides which attorney or which title company will be part of its package, and the consumer will have to accept that selection if it wants a loan from that lender. These adverse effects will be particularly severe in rural areas of the country where local attorneys and title companies will inevitably find that they cannot gain entry to the packages of the major lenders operating in that area.

The competitive advantage of small businesses—service to the consumer—will be undermined because the only successful marketing approaches will be those that enhance the profitability of the packages sold by the lenders. Likewise, there will be fewer competitive opportunities for new small businesses to enter this market since the only way they will be able break into the market will be to offer even greater discounts to lenders than those lenders can obtain from the major settlement service companies. This is unlikely to happen.

A review of the economic analysis on which HUD has based its evaluation of the savings associated with the changes proposed in their Rule raises many questions. HUD appears to have relied heavily, in their assumptions, on an extrapolation of data from FHA loans, which represent a small portion of the mortgage market. These are typically lower priced homes, not true examples of the residential housing market. Consequently, the sample on which the analysis is based is not typical.

In essence, the HUD packaging proposal is predicated on the expectation that there will be a substantial shift of revenue from settlement services providers to the major mortgage lenders, who will have the economic clout to obtain discounts as the price of entry into their packages, and that most or all of this revenue shift will be passed on to consumers. Apart from the fact that this is an artificial shift in revenues for which there is no significant justification, it is questionable how much of these discounts and rebates will trickle down to the consumer. The fact that so many major mortgage lenders are so strongly in favor of packaging suggests that they believe the profits from packaging are likely to be significant.

HUD's economic analyses concludes that lower prices for originators and third-party settlement service providers will drive out the less efficient firms, with the more efficient firms surviving and doing the work. This fails to recognize the current reality of the local marketplace and its potential evolution. Many counties in this country currently have only one closing or title agent. Some of these firms may be inefficient. However, particularly in rural areas, implementation of packaging could eliminate some of those providers, and consumers may not have *any* access to those services.

HUD has even posed questions in its Proposed Rule on the validity of State law. Specifically, HUD has asked what State laws merit preemption. Many State laws relating to title insurance, such as rate regulation, are designed as consumer protection measures which ensure adequate access to these services at a reasonable price.

Mr. Chairman, if small businesses cannot compete effectively with their larger competitors for the consumer's business, then, in the long run, they are not going to survive. But HUD's proposals do not create a playing field in which the most efficient, or the best, competitors end up winning the race. Rather, HUD's proposals create a playing field in which those lenders with the most clout, or those service providers who are best able to offer significant inducements to lenders to get into their packages, will end up winning the race. Small lenders may be very efficient at making mortgage loans, but if they lack the clout to obtain the kind of discounts that their larger lender competitors can squeeze out of service providers, they will not be able to compete effectively. In other words, they will lose market share not because they are inefficient *lenders,* but because they cannot command the kind of discounts from third-party providers that their larger competitors can command.

Similarly, smaller title companies or smaller providers of settlement services have demonstrated that they can compete effectively with their larger competitors in providing title and settlement services. But in the competitive world that HUD wants to create, these companies could well lose market share to their larger competitors who are in a better position to offer discounts or other things of value to lender-packagers. This would enable those lenders to realize greater profits on their packages than by including smaller providers in their packages. Again, smaller title com-

panies and other settlement service providers will lose market share not because they are inefficient providers of settlement services, but because they cannot provide the kind of discounts that their larger competitors can offer.

The bottom line is that consumers will effectively have fewer choices in their selection of providers of legal and title-related services for their real estate transactions. Under HUD's approach, the consumer selects the lender and must accept whatever service providers are in that lender's package. This is a problem with regard to services, such as those provided by lawyers and title companies and agencies that are provided for the benefit of the purchaser and seller of the real estate.

Consumers should have choice in the selection of their service providers, and this will not be possible under the Guaranteed Mortgage Package Agreement. In addition, HUD has estimated that some of the economic benefits of packaging will be time savings because consumers will not shop for settlement services, and lenders and settlement service providers will not have to answer questions. Achieving savings through reduced knowledge and understanding by consumers of their personal financial investments is not a good result.

HUD also estimates substantial savings to both consumers and service providers through reduced time spent in shopping for services and responding to consumer concerns. While we believe that the source and estimate of these savings is very uncertain, we also question whether elimination of time spent with consumers is a worthwhile goal. Consumers deserve to make informed decisions about the financial products and the services they choose.

ALTA's Proposal for a Two-Package Approach

ALTA's written comments to HUD did not merely criticize the HUD proposals. We offered a realistic alternative that we believe would achieve HUD's objectives while avoiding many of the consumer and competitive problems I have just discussed.

Our alternative is that there should be two packages:

- a "GUARANTEED MORTGAGE PACKAGE" that would be offered by lenders along the lines of the current HUD proposal (or as it may be modified after the public comment period) and that would consist of: (i) a loan at a guaranteed interest rate in accordance with whatever requirements HUD ultimately determines is appropriate; and (ii) all lender-related services and charges (basically the 800 series charges on the HUD–1 form).
- a "GUARANTEED SETTLEMENT PACKAGE" that could be offered by any party—title insurers and title insurance agents, real estate brokers, lenders, escrow companies, or attorneys—and that would provide a guaranteed single price for all of the 1100 series services and charges (the title and related charges), the 1200 series charges (Government recording and transfer charges), and those charges required for title assurance or closing purposes that may be listed in the 1300 series (miscellaneous settlement charges).

We believe this "two-package" approach would better achieve HUD's goals of: (1) ensuring price certainty in the settlement process for consumers, and (2) injecting significant, "shoppable" price competition into both the lending and the settlement industries. It will help ameliorate the effects on small business because it will allow lenders and others to package on a local level. This packaging alternative will take into account the unique costs, needs, and allocation of responsibilities that exist in a local jurisdiction, and allow customization to meet consumer needs. It would also serve other important goals, such as allowing for the development of Settlement Packages in purchase/sale transactions that differ from those in refinance transactions, that would accommodate regional differences in practices, and, most importantly, would permit settlement service providers to market directly to consumers, thus preserving the competitive access of the diverse and vibrant small businesses that make up a significant part of the American settlement industry.

We also have expressed concern that the HUD proposal might freeze the way in which settlement services are delivered, and prevent the evolution of new forms of service delivery. We believe the HUD proposal would channel settlement services primarily through large lenders, thus inhibiting the development of technological and market improvements that could lead in different directions. We expressed these concerns in the Mortgage Reform Working Group in the late 1990's. Since that time, technological advances have led to dramatic improvements in consumers' access to loan and settlement services information. Many consumers now shop online for both loan and settlement services, and some even close online. We believe that consumers would like to continue to take advantage of these opportunities.

It is particularly ironic that, at the same time HUD is pursuing a "packaging" approach that so clearly favors large companies over smaller business entities, the Bush Administration has proposed a strategy to all Federal agencies calling on them

to reduce the adverse impact on small business resulting from the "bundling" of Federal contracts. As discussed in the October 2002 OMB report entitled "Contract Bundling: A Strategy for Increasing Federal Contracting Opportunities for Small Business," bundling of Federal contracts has been an increasing practice in recent years so that fewer, larger groupings of contracts are put out for bid. While such bundling has made things easier for Federal contracting officers and their agencies, it has had the effect of eliminating competitive opportunities for small businesses which want to compete for Government contracts. To counteract that trend, OMB has urged Executive Branch agencies to revise their regulations to eliminate unnecessary contract bundling and, in the words of the Administrator of OMB's Office of Federal Procurement Policy, to make "a significant step forward toward ensuring that small businesses and entrepreneurs have access to Federal contracting opportunities." It seems to us that HUD's packaging proposal is completely out of step with the thrust of OMB's "unbundling" approach to Government contracts.

The loss of these small businesses will eliminate the local companies that support the community, provide jobs, and pay taxes.

We thank you for holding this hearing to address this most important issue.

PREPARED STATEMENT OF GARY E. ACOSTA

CHAIRMAN, NATIONAL ASSOCIATION OF HISPANIC REAL ESTATE PROFESSIONALS

APRIL 8, 2003

Chairman Shelby, Ranking Member Sarbanes, Members of this Committee, I am Gary Acosta, the President of SDF Realty in San Diego California and the Chairman of the National Association of Hispanic Real Estate Professionals (NAHREP), a nonprofit trade association dedicated to increasing the Hispanic homeownership rate. NAHREP is the Nation's fastest growing real estate trade organization and is a partner in President Bush's "Blueprint for the American Dream" minority homeownership initiative. We appreciate the opportunity to address the Committee today on the views and planned actions of the Department of Housing and Urban Development (HUD) on the proposed amendments to the regulations implementing the Real Estate Settlement Procedures Act (RESPA).

The NAHREP has over 10,000 members in 43 States. Our members come from all segments of the housing industry including but not limited to real estate agents and mortgage professionals. NAHREP provides professional education, industry representation, publications and technology solutions for those real estate professionals primarily dedicated to serving Hispanic homebuyers.

Hispanic Homebuyers are Underserved

Today, the homeownership rate in the United States stands at 68 percent; however, for Hispanic Americans it is about 47 percent. This disparity is driven by a number of factors including the lack of competitive mortgage financing in those markets. In addition, NAHREP estimates that approximately 80 percent of Hispanic homebuyers are first-time buyers—double the percentage of the overall market. Particularly for the first-time buyer, the purchase of a home is both a complicated and emotional experience, which often creates a more labor-intensive real estate transaction for the professional.

According to a recent study produced by Pepperdine University and the La Jolla Institute, up to 65 percent of Hispanic homebuyers prefer to communicate in Spanish, a skill possessed by a small percentage of real estate professionals. Additionally, many Hispanic consumers have thin credit files, little money for down payment, and multiple sources of income. In order to serve this market effectively, mortgage and real estate professionals must have specialized skills and have keen understanding of this market.

Accordingly, NAHREP supports policy and legislation that increases awareness, reduces cost, and simplifies the process of buying a home. In this regard, NAHREP applauds President Bush, and Secretary Mel Martinez for their demonstrated commitment to make homeownership attainable for more Hispanics, minorities, and other underserved Americans. In particular, we strongly support Secretary Mel Martinez's effort to simplify and improve the process of obtaining home mortgages, and to reduce the costs for future homebuyers.

Hispanic Consumers are Primarily Served by Small Business Professionals

A recent NAHREP member survey indicated that 81 percent of our members who are real estate agents "regularly use the services of a mortgage broker to arrange

financing for their clients." Latinos are more likely to use mortgage brokers and other small business professionals because they tend to live and work in the communities they serve and have strong language skills and cultural understanding. Today's mortgage industry is increasingly a formula-driven, high-volume, low-margin business. Larger players generally lack the flexibility and diverse personnel necessary to adequately serve homebuyers that do not always "fit in the box." For this reason, NAHREP believes that the growth in Hispanic homeownership will depend on Hispanic-owned small businesses in those communities.

HUD's Proposed Rules May Have an Unintended Impact on Small Real Estate and Mortgage Companies

NAHREP recognizes that HUD's Proposed Rules are designed to simplify the mortgage finance process and eliminate opportunities for predatory lending practices. NAHREP shares HUD's conviction that consumers should receive accurate information when choosing a mortgage originator in order to make an educated decision regarding mortgage products and services. We also believe that this outcome for the consumer could not be possible without real competition in the mortgage market. However, we see the potential for both the Enhanced Good Faith Estimate and the Guaranteed Mortgage Package to have unintended and detrimental effects on small real estate and mortgage companies that may prove to undermine the intended benefits to some consumers. As mentioned, it is the small real estate companies and mortgage brokers who often are committed to serving the Hispanic members of their communities and will be the drivers of increased homeownership for Hispanics. Placing small business owners at a disadvantage will ultimately hurt homeownership opportunities for the minorities NAHREP and others want to reach.

NAHREP Concerns With the Proposed Enhanced Good Faith Estimate

This Proposed Rule in connection with the Enhanced Good Faith Estimate (GFE) results in "different treatment of compensation in loans originated by lenders and those originated by mortgage brokers." This unequal treatment will create an uneven playing field among mortgage originators and disadvantage mortgage brokers compared to mortgage banks and lenders. In effect, a mortgage loan originated by a mortgage broker—who already has additional disclosure requirements—may look more expensive to the consumer than an identical loan originated through a direct lender. Even though mortgage bankers and national banks do compensate staff for mortgage originations, under the Proposed Rule neither are required to disclosure this compensation. In some cases, a consumer could select a more expensive product by assuming that the loan with no disclosed compensation to the originator is always a better deal.

The proposed changes to the GFE include a mandate to guarantee third-party costs within a "10 percent" or "zero" tolerance. NAHREP believes this is critical to helping consumers identify the best mortgage possible. Holding mortgage originators responsible for making accurate disclosures to consumers within 3 days of application is appropriate and reasonable and will eliminate abuse of the GFE. However, loan originators do not have control over certain third-party costs. There are many examples of legitimate, unexpected costs that arise between application and closing. To require the originator to absorb all unanticipated expenses would almost certainly pose a greater burden on a small broker than on a larger mortgage lender.

NAHREP recommends that when a price increases or a fee is added that changes the original GFE, a new GFE should be provided to the consumer within a reasonable timeframe along with an explanation of the change. This must take place before the consumer is at the settlement table.

NAHREP Concerns With the Guaranteed Mortgage Package

NAHREP also cautions HUD to consider the impact to small businesses of the proposed Guaranteed Mortgage Package (GMP). While we cannot know the exact impact to the marketplace of a GMP, we believe the packaging of settlement services offers a much greater business opportunity for large lenders than for small mortgage brokers or small real estate services providers and could ultimately hurt the consumers served by the small businesses. It is also possible that the GMP may eliminate the choice of Hispanic consumers to select settlement services that specialize in working with Spanish-speaking consumers.

NAHREP Appreciates the Opportunity to Share Our Views

The housing sector has been one of the few bright spots in our economy and Hispanic homebuyers have fueled the strength of our housing industry. Over the next two decades, nearly 80 percent of all new homebuyers will be minorities and/or immigrants. Again, I appreciate the opportunity to be here today to express NAHREP's

support for Secretary Martinez's effort to improve the process and reduce the cost of mortgage finance. The cautions I have expressed today are intended to ensure this effort results in the best possible outcome for consumers and the mortgage finance industry. I look forward to working with this Committee and HUD to ensure that a Final Rule will encourage more minority-owned small businesses to enter the real estate and real estate finance market and thereby help to increase homeownership opportunities particularly for minority families.

Thank you.

PREPARED STATEMENT OF CATHERINE B. WHATLEY

PRESIDENT, NATIONAL ASSOCIATION OF REALTORS®

APRIL 8, 2003

Good morning, Chairman Shelby, Senator Sarbanes, and Members of the Committee, I am Cathy Whatley and I am the 2003 President of the National Association of REALTORS®. I appreciate the opportunity to present to the Senate Banking Committee our thoughts on HUD's Proposed Rule to reform the Real Estate Settlement Procedures Act (RESPA). NAR is America's largest trade association, representing more than 860,000 members involved in all aspects of the residential and commercial real estate industries. When it comes to the home purchase transaction, REALTORS® hold the position closest to the consumer. From the very early stages of the home search to closing day, the REALTOR® is involved and acts as an adviser in the process. It is because of this very important role that we feel we can offer valuable insight into how these proposed changes may impact the consumer, as well as the industry.

NAR supports efforts to improve RESPA and the home mortgage transaction experience for consumers. We admire Secretary Martinez's dedication to this initiative and we appreciate and agree with the stated goals of reform as set forth by the Department: (1) to simplify and improve the process of obtaining home mortgages, and (2) to reduce settlement costs for consumers. However, I will state up-front, we have serious reservations as to whether the proposal as written meets these goals.

As you know, this proposal has generated significant response from all segments of the industry and consumer groups. In fact, only now that the comments are in can we truly appreciate the complexity of this proposal. While some may endorse the concept of the GMP, support is conditioned on the adoption of recommended changes and these changes are as numerous as the number of groups making them. How HUD responds to these recommendations will determine the level of future support or opposition. Unfortunately, the current process does not permit the industry to reassess the proposal relative to any changes HUD might consider upon review of the 45,000 comment letters. Therefore, we think HUD should amend the original proposal based on industry and consumer comments and reissue a revised proposal for additional comment.

NAR Position

I will summarize our overall reaction to this proposal, which we submitted in our comments to HUD.

- HUD proposes two new disclosure methods, the Guaranteed Mortgage Package (GMP) and the Enhanced Good Faith Estimate (GFE). We believe the goals of reform can be achieved by improving the current Good Faith Estimate (GFE). While the proposal before us must be more carefully constructed, we support the concept and recommend that further analysis and development of this concept be conducted. It makes more sense to build on a model that we know rather than one that is untested relative to consumer and/or industry benefit.
- The Guaranteed Mortgage Package (GMP) represents a radical departure from today's rules. There is not enough evidence of consumer and industry benefit to move forward with this at this time. Additional data collection, research, and analysis need to be conducted to provide evidence of significant benefits. There are risks inherent in this proposal and until more is known about the likely impacts, HUD should postpone advancing this kind of significant regulatory change.

REALTORS® is a registered collective membership mark which may be used only by real estate professionals who are members of the NATIONAL ASSOCIATION OF REALTORS® and subscribe to its strict Code of Ethics.

- Congress should address many of the changes to RESPA in this proposal. To propose a repeal of Section 8 or to require providers to fix their fees requires oversight by the body that created RESPA.

The Enhanced Good Faith Estimate (GFE)

The goals of reform, certainty, and simplicity can be achieved without sacrificing the important consumer protections of Section 8. The enhanced GFE imposes pricing discipline on lenders thus providing borrowers more certainty early in the process enabling them to shop and compare loans. It also clarifies that volume discounts are permissible, thereby encouraging lenders to seek discounts that can be passed on to consumers.

This incremental approach will reduce the potential for any market disruption and will pave the way for future changes as appropriate. Specifics of this approach need to be carefully studied to minimize burdens on the industry, such as the tolerances for those services not within the control of the lender. Clarifying that volume discounts are not a violation under RESPA should go a long way toward providing lenders who otherwise would not be inclined to seek these discounts for their customers. Additional thought on the mortgage broker compensation disclosure should also be more fully analyzed so the consumer is not further confused and the broker is not unfairly placed at a competitive disadvantage to a retail lender. There could also be small business implications that require additional scrutiny. The GFE form should be further reviewed and amended so borrowers can more easily reconcile it with the HUD–1 at closing. Additional thought must be given to the proposed penalties for noncompliance. To simply permit the borrower to walk away at closing is a disservice to everyone in the transaction including the borrower. Penalties must be stiff enough to discourage noncompliance and rational to ensure innocent parties to the transaction are not penalized. These improvements to the GFE will go a long way toward achieving the stated goals of the Department and are consistent with the original purpose of RESPA.

The Guaranteed Mortgage Package (GMP)

While being characterized as an improvement to the process, the GMP could produce unintended consequences for the consumer, the lending and entire settlement service industry. It could also negatively impact the overall economy. The proposal assumes an increase in competition will result from the packaging scheme and this competition will drive down prices and benefit consumers. However, we believe there is also the possibility that this proposal could increase concentration, reduce transparency, reduce the quality of services, and ultimately lead to higher closing costs. This will undoubtedly alter the lending and settlement services industries. We come to this conclusion after carefully weighing the benefits of the available reform options against the potential for negative market consequences due to the loss of RESPA's Section 8 consumer protections. What amounts to broad relief for one segment of the industry without evidence of consumer benefit or continued consumer protections represents a flawed approach to reform and should be revisited.

At first glance, the prospect of creating a simplified disclosure that includes an interest rate and lump sum closing costs at no cost to the consumer is appealing. However, upon further review, we find there are too many unanswered questions and concerns about this approach. The following is a summary of some of these concerns in the proposal.

The GMP Will Hurt Small Business

HUD's GMP proposal provides lenders with the very strong incentive of a Section 8 safe harbor for the packaging of settlement services. Therefore, it is likely the market will move in this direction. This proposal thus poses a serious threat to the settlement service industries that may already be offering a form of bundling or one-stop-shopping to their customers. These companies will not be able to compete with the large lenders who will now be offered a huge incentive to package.

HUD assumes a savings of $1.8 billion in third-party settlement costs. NAR believes HUD should conduct additional analysis to more fully quantify and qualify this benefit relative to the loss in the marketplace of third-party settlement providers. Ensuring an abundance of providers creates a healthy and competitive market where the consumer has choices and can base their choices on both price and quality. To create incentives that merely encourage consolidation without regard for the quality of services being provided by the small businesses in today's competitive environment should be reviewed more closely.

The GMP Limits Packaging to Lenders

The proposal states, "anyone can package." This is a misleading statement because HUD's requirements for the safe harbor under the GMP are that the package must be advertised with a guaranteed interest rate. The only players in the marketplace that can offer a guaranteed interest rate are the lenders. This is confirmed in another provision that requires the GMP to be signed by a lender. Therefore, real estate brokers will only be able to offer packages if they form a relationship with a lender. Even then, the terms of the relationship and the package arrangements will be subject to the specific lender requirements. They will not be able to market their services directly to consumers. Packagers will always be under the control of the lender. Therefore, the rest of my comments will reflect the lender as the intended packager.

Simplification

The proposed GMP disclosure includes the interest rate, APR, and a lump sum package price for settlement services. However, there are three other required settlement costs that are not included in the package and disclosed separately. They are per diem interest, reserves/escrow, and hazard insurance. In addition, there is an optional owner's title insurance disclosure. While it may be easy enough to add these costs to the lump sum GMP, we must not assume how the Final Rule will reflect these disclosures. In public comments to HUD, several lender groups have advocated the removal of some of the services within HUD's GMP and to disclose them separately. Some of the services they recommend to exclude from the package are flood insurance, mortgage insurance, Government fees, and points. If HUD agrees with this assessment, the disclosure becomes very complicated. So the new disclosure would include the cost disclosures for the interest rate, points, the guaranteed package, per diem interest, reserves, hazard insurance, mortgage insurance, and flood insurance. Under this scenario, there may be more services outside than inside the guaranteed package.

Interest Rate Guarantee

The HUD GMP proposal requires an interest rate guarantee, subject to change resulting only from a change in an observable and verifiable index and it must remain open to the potential borrower for 30 days. The reason for linking the two is to prevent a lender from increasing the interest rate to make up for any losses on the guaranteed package. While lenders may find the interest rate guarantee unworkable, to deviate from this requirement will undermine the rationale for the GMP in the first place. To guarantee one piece of the offer and not the other can lead to bait and switch tactics and other abusive practices. Therefore, additional analysis is required to assess the impact of both guaranteeing the interest rate and removing the guaranteed interest rate from the GMP.

Certainty of Costs

HUD has indicated one of its goals in this proposal is to protect consumers by providing some cost certainties in the mortgage transaction, hence the "guarantee" in the GMP. The Rule, however, appears to have a loophole that negates the contractual "guarantee," specifically, the condition of "pending final underwriting and appraisal." Under this proposal, there is nothing to prevent a lender from trying to lure consumers with a below-market GMP, and then increase the interest rate or costs following final underwriting, which can take place right up to the closing. Therefore, it is questionable as to whether the consumer is truly getting a guarantee. It sounds more like a conditional guarantee of interest rate and costs.

Transparency in the Process

In the HUD proposal there is much emphasis placed on creating a transparent process. However, the GMP will result in quite the opposite. Borrowers will shop for a loan based on an interest rate and a "black box" of settlement costs. To move from a process today where borrowers are fully informed of the various services required to close the transaction to one in which the borrower is assumed to only be interested in the lump price of the package is taking a step backwards in the area of consumer education. Despite claims to the contrary, consumers want to know what they are getting for their money. If services are not disclosed to the borrower, true comparisons cannot be made. Even in the 1998 HUD/Fed Report, they recommended that *"consumers want to know what services they are purchasing, . . ."* and so they suggested the services in the package be itemized.

If nothing else, HUD needs to recognize this flaw in the proposal. Both services and quality of services matter to consumers. While lenders contend that these serv-

ices are for their use, the borrower pays for them and is directly impacted by the quality of the service providers. For example, a lender may have a contract with a certain pest control company and includes this service in its package. The pest control company may not be very reputable yet meets the minimal needs of the lender. Substandard work could mean problems in the future that may result in thousands of dollars for the homeowner.

In the home purchase market, most borrowers rely on trusted advisers, such as real estate agents in the selection of settlement services. Under today's Rules that prohibit settlement providers from paying or accepting fees for the referral of business, the only driving force behind a referral of business from a real estate agent to another provider is continued customer satisfaction from trusted providers in the marketplace. It is widely acknowledged that if a borrower is not satisfied or has a negative experience with a certain provider in the transaction, it is the real estate agent who makes things right. Under HUD's GMP proposal, the ability to guide the borrower through the transaction is restricted by these prearranged packages where services are not disclosed and service quality may be at risk. As pressure mounts on settlement providers such as appraisers, title companies, pest inspectors to drastically cut their prices to ensure inclusion in a lender package, quality of service could deteriorate. This scenario further underscores the need for full disclosure of services in a package.

Increased Competition or Increased Concentration

There is the likelihood that HUD's packaging proposal can lead to increased concentration within the industry and reduce competition. Lenders will be provided a financial incentive (Section 8 exemption) to package with no obligation to pass along discounts to borrowers and as a result will control the entire mortgage transaction. This will most likely lead to increased market share of the large lenders who already control the lion's share of the mortgage origination and servicing market. Small service providers including real estate brokerages with ancillary services will be at risk. Today, the real estate transaction is still very much locally based. Small and mid-size service providers offer competitive choices to borrowers.

Any regulation that moves an industry toward a more concentrated market structure should be viewed with considerable caution. An increased concentration of powers into the hands of a smaller number of large lenders and service providers could lead to higher closing costs—the exact opposite of HUD's stated goals for reform. Until the impact of this proposal is more fully understood, HUD should conduct the appropriate analysis and postpone any further action.

Alternative to the GMP

We strongly believe there are serious flaws in the GMP proposal and believe they should instead pursue changes to the GFE that will provide some certainty about costs and simplify the process. However, if HUD is committed to moving forward with a Guaranteed Packaging Rule as outlined in their proposal, we recommend a restructuring of the GMP. If the intent is to promote competition among nonlender packagers, a mechanism must be designed that will truly allow anyone to package independent of the loan. If designed correctly, it may offer opportunities for nonlender packagers, such as real estate brokers, title companies, and others to provide alternative choices for the consumer, which do not exist under this proposal.

To date it appears the only alternative that would meet this objective is to split HUD's GMP into two independent guaranteed packages:

- LENDER SERVICE PACKAGE: This package would include the lender services and perhaps the appraisal and credit report (800 series services on the HUD–1).
- CLOSING PACKAGE: This package would include all of the other services such as title, inspections, surveys, Government fees, etc. (1100, 1200, 1300 series services on the HUD–1).

Under the two-package system, a lender could offer a lender package along with a guaranteed interest rate. Anyone, including nonlenders, such as real estate professionals could offer the closing package. The conditions for receiving the Section 8 safe harbor would have to be carefully defined but would be available to both packages. Packagers will be eligible for compensation within the package for services rendered and do not necessarily have to provide a specific settlement service. Some minimal requirements would include:

- A lender could not require a borrower who is obtaining the lender's loan and the lender package to also purchase the lender-closing package. In other words, the lender cannot tie their loan to a particular closing package.

- The services within the packages, both the lender and closing cost packages, would be itemized. Upon request of the borrower, the service providers should also be disclosed.
- Lenders should provide copies of all reports to borrowers, for example, the credit report, appraisal, etc. Lenders should also disclose to borrowers the type of appraisal used by the lender, for example Automated Valuation Model (AVM), a drive-by, or a full appraisal.
- HUD should move toward adopting and requiring uniform service fee descriptions so borrowers can make apples-to-apples comparisons.

Under this proposal, large lenders will still have a competitive advantage with the Section 8 exemption. However, it is anticipated that the lender tying prohibition of the closing package will provide a nonlender some opportunity to compete in this market by offering these services directly to the consumer. The details of such a proposal requires further development and analysis to ensure it creates adequate opportunity for other market players to compete. Further, if HUD pursues this disclosure track, then it would be appropriate to delay implementation of the Enhanced Good Faith Estimate.

Additional Research and Analysis by HUD is Imperative Before Advancing this Proposal

The above issues argue the need for additional study on this proposal, the need for alternative approaches to the GMP, and its impact on the consumer, as well as the industry. Not enough is known about the likely impact of the GMP to support advancing this concept at this time. An incremental approach, such as the improved GFE is a more attractive option for satisfying HUD's stated goals for reform. By simplifying the GFE and clarifying that volume discounts are not violations of RESPA, HUD has created the necessary environment for packaging to occur.

Regardless of which approach to reform HUD endorses, Congress should be consulted before any final action is taken. We are very supportive of these Congressional hearings and would like to serve as a resource as the Committee continues to review this proposal. There is too much at risk to move forward in a less than thoughtful and deliberative manner. While we support the concept of the Enhanced GFE, we question whether HUD has the authority to require lenders to guarantee their fees. Similarly, repealing Section 8, a core provision of RESPA, should receive considerable debate on Capitol Hill by the body that created it in the first place. What Congress deemed a prohibited practice, HUD recommends looking the other way as long as the prices are guaranteed.

As you know, the Small Business Administration's (SBA) Office of Advocacy has submitted comments to HUD. They encouraged HUD to issue a revised Initial Regulatory Flexibility Analysis (IRFA) that takes into consideration the comments of affected small entities and develops regulatory alternatives to achieve HUD's objectives while minimizing the impact on small business. They are of the opinion that further economic analysis prepared by HUD, in a revised IRFA, would improve the Final Rule. This is consistent with our belief that additional analysis is needed before moving forward with this proposal.

Conclusion

Let me conclude by calling to your attention HUD's statements in the Proposed Rule under the Supplementary Information Section.

"The American mortgage finance system is justifiably the envy of the world. It has offered unparalleled financing opportunities under virtually all economic conditions to a very wide range of borrowers that, in no small part, have led to the highest homeownership rate in the Nation's history."

This statement should serve as a reminder that before HUD moves forward with an untested model, it must be sure it does not jeopardize a system that despite its flaws is still working well for most Americans.

In light of this, we encourage further development of the Enhanced GFE concept as a means to make incremental changes to a system that we know and understand. If this were not a viable option, then we would strongly recommend further analysis and development of a two-package approach to the GMP. Unless there is a real opportunity for providers other than lenders to offer packaged settlement services to consumers, the negative consequences of HUD's proposed GMP will far outweigh any potential benefits to consumers.

I thank you for the opportunity to express the views of the National Association of REALTORS® and stand eager to work with Congress to address these issues.

PREPARED STATEMENT OF MARGOT SAUNDERS

MANAGING ATTORNEY, NATIONAL CONSUMER LAW CENTER
ON BEHALF OF THE
CONSUMER FEDERATION OF AMERICA, CONSUMERS UNION, AND
U.S. PUBLIC INTEREST RESEARCH GROUP

APRIL 8, 2003

Mr. Chairman, Senator Sarbanes, and Members of the Committee, the National Consumer Law Center[1] thanks you for inviting us to testify today regarding HUD's proposal to rewrite the RESPA Rules. We offer our testimony here on behalf of our low-income clients, as well as the Consumer Federation of America, Consumers Union, and the U.S. Public Interest Research Group.[2]

We wish to commend Secretary Martinez for the dramatic approach to RESPA[3] reform advocated in these Proposed Rules. Clearly, the Department has recognized that the current state of RESPA's consumer protection is a murky mess. The stated goals and orientation of the Proposed Rule are wonderful—to protect consumers. We credit the hard work and creativity of HUD staff in the conception of this Rule. We applaud the many positive features of these proposals, and we commend HUD's steadfast commitment to ensuring that consumers benefit from these changes.

There are real complexities in these new proposals for RESPA compliance, with dramatic impact on determining compliance with the Truth in Lending Act and the Home Ownership and Equity Protection Act. In this testimony, we strive to make clear our support for HUD's efforts to protect consumers through the Proposed RESPA Rules. While we have concerns[4] regarding a number of important details, this should not be regarded as diminishing our overall support for the basics of HUD's proposals:

- YIELD SPREAD PREMIUMS. Consumers need better protections from overcharges resulting from improper payments of yield spread premiums (YSP) from lenders to brokers. The Proposed Rule on new disclosures for yield spread premiums does give consumers important information to assist them in ensuring that yield spread premiums are used as they direct. However, the Rule, as currently proposed, lacks an effective enforcement mechanism.
- MORE MEANINGFUL GOOD FAITH ESTIMATE. Currently the GFE provides no information upon which a borrower can rely. HUD's proposal appropriately requires that the loan originator—who is in the best position to know the prices for the required services—provide estimates for closing costs that are reasonably close to what actually will be charged to the consumer.

[1] The NATIONAL CONSUMER LAW CENTER is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, Government, and private attorneys, as well as community groups and organizations, from all States who represent low-income and elderly individuals on consumer issues. As a result of our daily contact with these advocates, we have seen examples of predatory practices against low-income people in almost every State in the Union. It is from this vantage point—many years of dealing with the abusive transactions thrust upon the less sophisticated and the less powerful in our communities—that we supply these comments. We have led the effort to ensure that electronic transactions subject to both Federal and State laws provide an appropriate level of consumer protections. We publish and annually supplement twelve practice treatises which describe the law currently applicable to all types of consumer transactions.

[2] The CONSUMER FEDERATION OF AMERICA is a nonprofit association of over 280 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

CONSUMERS UNION is the nonprofit publisher of *Consumer Reports* magazine, is an organization created to provide consumers with information, education, and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports,* its other publications and from noncommercial contributions, grants, and fees. Consumers Union's publications carry no advertising and receive no commercial support.

The U.S. PUBLIC INTEREST RESEARCH GROUP is the national lobbying office for State PIRG's, which are nonprofit, nonpartisan consumer advocacy groups with half a million citizen members around the country.

[3] The Real Estate Settlement and Procedures Act (RESPA), 12 U.S.C. § 2601, *et seq.*

[4] As this testimony can only provide a summary of the many issues which must be addressed in the Proposed Rules, we point you to the comprehensive comments that we filed with HUD, available on our website at *www.consumerlaw.org.* Our comments to HUD were provided on behalf of our low-income clients, five national consumer advocacy groups, as well as the clients of 17 legal services programs in urban and rural areas throughout the Nation. Portions of our comments to HUD are reiterated in this written testimony.

- GUARANTEE OF COSTS AND INTEREST. The innovative proposal for a Guarantee Mortgage Package Agreement (GMPA) will help simplify the mortgage *shopping* process for those consumers in the prime mortgage who carefully evaluate their mortgage options. Because the GMPA will effectively mask many of the initial disbursements, we are concerned that the package not be allowed to be used by lenders to shield predatory loans from legal scrutiny.

There are several overarching concerns and a myriad of important details which must be worked through to ensure that the Rule does, in fact, protect consumers, instead of simply providing a shield behind which mortgage originators can hide inappropriate, unfair, and illegal activities. While the overall concepts are excellent, we have been advocating some significant changes in the details of the Rules to prevent substantial harm to consumers. However, we want to be absolutely clear that our most important concern has to do with the Rule's potential to *facilitate* predatory lending.

The single most critical point for the representatives of low- and middle-income consumers providing these comments is that HUD limit the Guaranteed Mortgage Package Agreement (GMPA) to prime loans. If subprime loans are permitted to be made through the GMPA structure, ***predatory lending*** *will be facilitated and protected by the GMPA exemption.* This means that HUD must go *beyond* its current proposal to exclude only HOEPA loans from the GMPA exemption, and exclude all loans with subprime characteristics.

SUMMARY OF CONCERNS

To Avoid Facilitating Predatory Lending, The GMPA Should Be Limited To Prime Loans

The idea behind the Guaranteed Mortgage Package Agreement is to simplify the mortgage shopping process by both bundling the loan closing costs with the loan points, and providing an interest rate guarantee based on the borrower's credit qualifications. This would accomplish two important goals: (1) it would allow borrowers to shop for loans based simply on the interest rate and the money required to obtain the loan; and (2) it would permit borrowers to apply to numerous lenders and receive guarantees of the loans for which they actually qualify, subject only to verification of the information the consumer has provided about the value of the home, the borrower's income, and other assets. The most important aspect of the GMPA is that it allows borrowers to obtain loan guarantees based on their actual credit rating very early in the process. This will prevent tremendous misunderstanding and allow borrowers with less than perfect credit to participate fully in the shopping process.

The GMPA is a creative and novel proposal which, if implemented properly, will enable borrowers in *certain mortgage markets* to shop more effectively. However, HUD must keep in mind that this shopping does not occur among all consumers—those who are today already the victims of predatory mortgages and those who will be targeted in the future. Predatory lending in the subprime market thrives in an atmosphere in which lenders and brokers target homeowners and experience little pressure to provide the best products. Indeed, the incentives run in the other direction—borrowers are steered to the worst products. The GMPA must not provide a new means for lenders in the subprime market to avoid liability for noncompliance with consumer protection laws in that segment of the marketplace which most needs *more* substantive consumer protection.[5]

As the GMPA streamlines disclosure of specific charges and services it will allow mortgage originators to hide illegal fees and insulate lenders from legal challenges under both RESPA and the Truth in Lending Act (TILA).[6] It was HUD's intent to

[5] We have supported the concept of the GMPA in the past in the context of statutory change in the law. Amending the RESPA and TILA *statutes* would allow all the overlapping issues of disclosures under both statutes, enforcement, and protections against predatory lending, to be addressed together. Attempting to address the disclosure problems of RESPA only through regulation unfortunately creates serious implications for enforcing TILA requirements and removes existing protections against predatory lending. *See* Margot Saunders, Testimony Regarding the *Rewrite of the Truth in Lending Act and Real Estate Settlement Procedures Act* (September 16, 1998), available online at *http://www.consumerlaw.org/initiatives/predatory_mortgage/sen_mortg.shtml.*

[6] 15 U.S.C. § 1601 *et seq.* Currently, compliance with TILA's required allocation of fees between amount financed and finance charge can be tested only by comparing the disclosure of specific fees provided on the RESPA HUD–1 with the statements of the disclosures provided on the TILA form. Though TILA generally requires the lender to provide the borrower with an itemization of the amount financed unless the consumer opts out, lenders need not give this itemization if they provide both the GFE and HUD–1. Official Staff Commentary § 226.18(c)-4.

encourage packaging by trading compliance with the specific requirements of RESPA's Section 8.[7] However, an *inadvertent* result of the GMPA will be to conceal information needed to determine the accuracy of TILA disclosures as well, providing legal insulation from both Federal laws. One of the effects of the bundling of loan fees under the Guaranteed Mortgage Package will be that TILA compliance will no longer be discernable by a comparison of the TILA disclosure and the HUD–1.[8] High cost loans may be successfully camouflaged from challenge under TILA regulations, or even HOEPA compliance, as a result. Neither bank regulators nor others reviewing mortgage loans will be able to perform accurate compliance reviews.

As the purpose of the GMPA is to encourage shopping in the open marketplace of competitive mortgage lending, the GMPA should only be provided to that section of the market which is most capable of using competitive pressures in the open marketplace to protect themselves—the prime market. This is essential. *To ensure that HUD's new GMPA does **not** facilitate and protect predatory loans from legal scrutiny, any loan that meets any one of the following triggers should **not** be permitted to be made as a GMPA:*

- Any HOEPA loan.
- Any loan with a prepayment penalty.
- Any loan with a Guaranteed Mortgage Package price (the single fee)—which equals or exceeds 5 percent of the principal of the loan.

HOEPA LOANS CAN BE MISCHARACTERIZED, YET PROTECTED FROM CHALLENGE IN A GMPA

The Home Ownership and Equity Protection Act, passed in 1994,[9] does not cure the problem of abusive home equity lending. The law continues to allow high rate home equity loans to be made and does not regulate excessive interest rates or fees *per se.* Its coverage is limited, excluding loans with high rates and fees just under the trigger amounts, open-end home equity credit, and reverse mortgages.[10] Extraordinarily abusive loans can continue to be made without triggering HOEPA protections because lenders can easily circumvent HOEPA by charging rates and fees just under the HOEPA trigger amounts.

As a result, in many high cost loans, there is litigation regarding whether the fees charged by the lender have been properly allocated to the HOEPA points and fees trigger. Many loans are treated by lenders as non-HOEPA loans, only to be determined later by regulators or attorneys for consumers to have been wrongly excluded from HOEPA. Once it is shown that a loan should have been covered by HOEPA, but was not, considerable consumer protections then apply.[11] A lender who violates the requirements of HOEPA faces enhanced statutory penalties, as well as rescission of the loan.[12] The protections of HOEPA are thus most often helpful to consumers when they have been breached—because they provide substantial assistance in avoiding foreclosure on loans which included abusive terms.

The HUD–1 required by RESPA satisfies the requirement under TILA that an itemization of the amount financed be made available to the borrower. This itemization is critical for determining not just TILA compliance but also whether the loan is covered by HOEPA. The GMPA would make it impossible for consumers—or regulators—to determine whether a loan presented as a non-HOEPA loan was actually a HOEPA loan.

This is why the GMPA cannot be permitted to mask the fees of loans which are anywhere in the neighborhood of HOEPA loans—else substantially abusive loans will be made under the rubric of the GMPA, thus denying to consumers the ability to test these loans for compliance with the Truth in Lending Act and appropriate exclusion from HOEPA.

---

[7] 12 U.S.C. § 2607.

[8] This situation may change if the Federal Reserve Board issues new regulations or new comments under TILA requiring otherwise. These comments evaluate the effect of the Proposed RESPA Rule on existing interpretations of TILA Rules.

[9] Codified at Section 129 (15 U.S.C. § 1639) and in Sections 31 and 32 of Regulation Z (12 CFR §§ 226.31 and 226.32).

[10] 15 U.S.C. § 1602(aa)(1).

[11] For example, only HOEPA loans require the extra disclosure required 3 days before closing, as well as limitations of the circumstances in which prepayment penalties can be charged (15 U.S.C. § 1639(c)), special requirements for payments made to home improvement contractors (15 U.S.C. § 1639(i)), and prohibitions on extending credit without regard to the consumer's payment ability (15 U.S.C. § 1639(h)).

[12] 15 U.S.C. § 1640(a) and 15 U.S.C. § 1635.

ALL SUBPRIME LOANS SHOULD BE EXCLUDED FROM THE GMPA

We know the *characteristics* of *predatory* loans. HOEPA only covers a small percentage of subprime loans.[13] HUD has proposed only to exclude HOEPA loans from the GMPA. This does not provide nearly enough protection. Currently advocates estimate the bulk of predatory loans finance between 5 to 8 percent of the principal of the loan as points, fees, and closing costs.[14] HUD has already stated that financing more than 3 percent of points and fees is a sign of a predatory loan.[15] Further, in its regulations of the GSE's, HUD has prohibited the provision of housing credits for loans in which more than 5 percent of the principal has been charged.[16] It is also important to note that many of the new anti-predatory lending laws passed by the States have used 5 percent points and fees as a trigger for coverage.[17]

Thus, to ensure that HUD's new GMPA does *not* facilitate and protect predatory loans from legal scrutiny, any loan that meets any one of the following triggers should *not* be permitted to be made as a GMPA: Any HOEPA loan, any loan with a prepayment penalty, and any loan with a Guaranteed Mortgage Package price (the single fee)—which equals or exceeds 5 percent of the principal of the loan.

In other words, in addition to HOEPA loans, any loan which has *either* a prepayment penalty, *or* the price for the GMPA is equal to or more than the 5 percent of the loan principal must not be eligible for the exemption outlined in the Proposed Rule. Any lender making a loan with either of these criteria would still be required to itemize the fees paid to settlement service providers pursuant to the Rules for the Good Faith Estimate.

GMPA Should Not Be Permitted For Loans With High Points And Fees

As predatory loans generally charge high points and fees it is essential that the GMPA not be permitted to be provided for these loans. The most meaningful mark of a predatory loan is in the high amount of points and fees[18] financed by the borrower. The more the borrower is charged up-front, the more the immediate financial gain achieved by the lender. This is why many of these loans are not affordable to the homeowner—the lender has an incentive to make them nonperforming loans. If that loan does not perform such that the homeowner is forced to refinance, it just means more profit for the lender at each refinancing. For the homeowner, it means more equity is stripped from the home each time.

Using 5 percent of the principal as the trigger for exclusion from the GMPA eligibility will still allow loans with very high up-front costs to be made with a GMPA. According to various studies, closing costs on conventional mortgages rarely exceed 2 percent of the loan amount.[19] Using 5 percent as the trigger allows ample (perhaps too much?) room to ensure that all prime loans for which a GMPA might be appropriate would be eligible for the competitive benefits of the GMPA. However, this figure also ensures that loans which are not truly competitive are excluded from the exemption.[20]

---

[13] Federal Reserve Board, Final Rule, Statement of Basis and Purpose, 66 Fed. Reg. 65604, 65607 (December 20, 2001).

[14] This information is gleaned from the hundreds of loan documents reviewed each year by the attorneys providing these comments. *See also* Washington Department of Financial Institutions, Expanded Report of Examination for Household Financial Corporation III as of April 30, 2002, at 48 (finding that Household charged 7.4 percent in up-front costs on most loans), *available from* the National Center on Poverty Law as Clearinghouse No. 54,580.

[15] *See* Joint HUD–TREASURY Report on Recommendations to Curb Predatory Home Mortgage Lending, June 20, 2000, at page 11. *http://www.hud.gov/library/bookshelf18/pressrel/pr00–142.html.* The agencies noted the dangers to homeowners of financing high fees:

Financing points and fees may disguise the true cost of credit to the borrower, especially for high interest rate loans. Restricting the financing of points and fees for HOEPA loans would cause these costs to be reflected in the interest rate, enabling borrowers to better understand the cost of the loan, and to shop for better terms.

[16] *See* 24 CFR 81.16(b)(12) and 24 CFR 81.2. These regulations do allow third-party fees paid for closing costs to be excluded from the 5 percent calculation. However, as these third-party fees would not be itemized on the GMPA, excluding some fees would not be possible. It is also far better, at this point of the development of this new product to exclude too many loans, rather than to include too many, which would have the effect of limiting enforcement of existing law on predatory mortgages.

[17] *See, e.g.,* N.C.G.S. S.L. 1999–332; Ga. Code Section 7–6A–1 *et seq.*; 2001 N.Y. A.B. 11856 (SN) (October 3, 2002).

[18] We include in our definition of fees, the high costs of single premium credit insurance.

[19] According to the Federal Housing Finance Board's *"Monthly Interest Rate Survey,"* Table 1: Terms on Conventional Single-Family Mortgages, Annual National Averages, All Homes, *available at www.fhfb.gov/MIRS/mirs_t1.xls, initial fees and charges average less than one point from 1995 through 2000 on conventional residential mortgages.*

[20] For example, a loan of $150,000 would be permitted to have a GMPA package cost of $7,499. A $200,000 loan could have a GMPA price of $9,999. These up-front costs are actually

GMPA Should Not Be Permitted For Loans With Prepayment Penalties

Prepayment penalties also are the mark of a predatory loan, and lenders providing GMPA's should not be permitted to include prepayment penalties.

When a lender extends considerable expenses in the making of a loan, the lender does risk loss if the loan is prepaid before the regular payments on the loan allow the recoupment of these expenses. In the prime mortgage market, the effect of competition protects lenders: The low-interest rate the borrower currently has discourages the borrower from prepaying the loan. Typical prime mortgage loans stay on the books for an average of 5 years. Thus, only 2 percent of prime loans have a prepayment penalty.[21]

However, fully 70 percent of subprime loans have prepayment penalties because of lack of perceived options on the part of the borrowers.[22] In the subprime mortgage market, the brokers are generally the gatekeepers for the loans, and they operate on the reverse competition method of yield spread premiums. The higher the premium paid to a broker, the more likely the broker will match a lender up with an unwitting borrower. The hefty price paid to the broker in the yield spread premium is an expense that the lender must recoup in order to avoid a loss, especially considering that the same broker has an incentive to market aggressively another loan to the same borrower. Thus, the lender must charge prepayment penalties to protect itself from the costs incurred by yield spread premiums.

If prepayment penalties were disallowed, unreasonable yield spread premiums would not be paid by lenders, because they could not afford the risk. This would not mean that loans would not be made—they are made every day in the prime market without hefty premiums and prepayment penalties. As yield spread premiums are completely masked in the GMPA—unreasonable yield spread premiums should not be encouraged by allowing loans with prepayment penalties to be included in the exemptions offered by the GMPA.[23]

It is clear to many that prepayment penalties on subprime loans have virtually nothing to do with lowered interest rates.[24] It therefore cannot be argued that precluding loans with prepayment penalties will deprive most borrowers of a viable way to decrease interest rates.

The GMPA Should Not Be Implemented Without Resolving Its Effect On TILA Compliance

To ensure that the GMPA does not create havoc with compliance and enforcement of TILA, HUD should move forward on the GMPA portion of the Proposed Rule only after coordinating with the Federal Reserve Board to ensure that compliance with TILA maintains the current degree of transparency in home mortgage loans. TILA and RESPA are connected in several ways. Overhauling RESPA as suggested will create havoc to the balance currently struck between RESPA and TILA.[25]

---

much higher than most competitive, prime loans would ever charge for up-front closing costs. To the extent that the figure of 5 percent may represent too small a sum to compensate lenders for their up-front costs when making small loans (for example, loans of less than $75,000), the 5 percent trigger could be adjusted upward. However, just as this figure is adjusted upward for smaller loans, the 5 percent trigger should also be adjusted lower for loans of larger amounts.

[21] *See* Freddie Mac, Frequently Asked Questions on Prepayment Penalties, *available at http://www.freddiemac.com/singlefamily/ppmqanda.html.*

[22] *See* Gail McDermott, Leslie Albergo, Natalie Abrams, Esq., NIMS Analysis: Valuing Prepayment Penalty Fee Income Standard & Poor's, News Release, January 4, 2001. *Also see,* North Carolina Coalition for Responsible Lending, Prevalence of Prepayment Penalties, available at *http://www.responsiblelending.org/PL%20–%20Coalition%20Studies.htm* citing data obtained in an interview with the Mortgage Information Corporation and the industry newsletter, *Inside Mortgage Finance,* and the following articles on conforming mortgages: *"Freddie offers a new A–, prepay-penalty program,"* Mortgage Marketplace, May 24, 1999; Joshua Brockman, *"Fannie revamps prepayment-penalty bonds,"* American Banker, July 20, 1999.

[23] Subprime lenders claim that borrowers voluntarily choose prepayment penalties to reduce their interest rates. Borrower choice cannot explain, however, why some 70 percent of subprime loans currently charge prepayment penalties and only 2 percent of conventional loans do (almost all in California). The real reason is that conventional mortgage markets are competitive and sophisticated borrowers have the bargaining power to avoid these fees; borrowers in subprime markets often lack sophistication or are desperate for funds and simply accept the penalty that lenders insist that they take. In addition, predatory lenders favor prepayment penalties as a way of preventing borrowers from seeking more competitive rates and terms once they realize what has happened.

[24] *See e.g.,* Amy Crew Cutts, *On the Economics of Subprime Lending,* The FTC Roundtable: Economic Perspectives on the Home Mortgage Market, Washington, DC, October 16, 2002, Slide 2.

[25] Of relevance to this discussion, TILA requires the lender to give the consumer an itemization of the amount financed, including the sum of the prepaid finance charges. However, the

Continued

In transactions to which RESPA applies, TILA Rules say that the lender need not give an itemization of the amount financed if it provides both the GFE and HUD–1.[26] Mortgage lenders have consistently used the GFE and HUD–1 as a replacement for the itemization of the amount financed.[27]

The importance of the consumer receiving an itemization of the closing costs for TILA compliance purposes cannot be overstated. This is the only way that both regulators and consumers can determine if the APR, finance charge, and amount financed disclosures are accurate. The effect of the proposed GMPA disclosure is to eliminate the itemization of the closing charges, at least on any form provided under RESPA. Since the HUD–1 substitutes for the TILA itemization, the effect of using the proposed truncated HUD–1 will be that neither consumers nor regulators will be able to review the TILA cost of credit disclosures for accuracy.[28]

Given the interplay between TILA and RESPA, it is imperative that HUD not move forward on implementation of the GMPA unless TILA and HOEPA compliance can be enforced.

The GMPA Rules Must Be Tightened

If designed properly, with all of the issues relating to compliance with TILA resolved, and limited to the prime market, the Guaranteed Mortgage Package should prove helpful for consumers who shop in a competitive marketplace for their mortgages. In such a market, the GMPA would facilitate the ability of consumers to compare mortgage products that are actually available to them. With automated underwriting, mortgage lenders can (and already do in some instances) easily provide consumers guaranteed information about closing costs, interest rate, and points early enough so that they can shop and make informed choices in a quick and timely manner. Only this type of inclusive disclosure would clearly meet the purposes of RESPA and offer American homeowners a real opportunity to choose the best loan available for their individual needs.

Under the current scheme of mortgage financing, very few consumers know with certainty the interest rate or the total points and closing costs they will be charged for a mortgage loan before they have to pay the fees for application, credit report, appraisal, etc. Instead, consumers must generally pay a fairly sizable sum to apply for a mortgage loan, the full cost of which they will not know until some later time. The effect of the current industry practice is that even sophisticated consumers find it next to impossible to ensure that they are receiving the best loan that fits their needs. Moreover, unscrupulous brokers and lenders have a virtually free hand to increase the junk fees, points and/or interest rates on the loans.[29] Essentially, mortgage borrowing today is like what some people call "buying a pig in a poke." You pay before you know what you are getting.

The better system is one in which the consumer can apply, at little charge, to the several lenders receiving the credit report, answer any additional questions the lenders request, and then receive from each of the lenders a guarantee of a loan at a specific rate, with a fixed amount of points charged, and a guarantee of the full amount of closing costs to be charged.[30] This guarantee should be subject *only* to two contingencies: (1) that the information supplied by the consumer regarding income and assets could be verified; and (2) that the value of the collateral—the consumers' residence—was sufficient to secure the loan. Under this method, consumers would actually know the full price for a mortgage loan before they paid for it.

---

lender need not give the itemization if the consumer opts out of receiving it. 15 U.S.C. § 1638(a)(2)(B); Reg. Z § 226.18(c).

[26] Official Staff Commentary on Regulation Z, § 226.18(c)–4.

[27] TILA and RESPA also intersect when the mortgage transaction involves the purchase, acquisition, or construction of the home securing the mortgage. In the purchase-money context where the mortgage loan is subject to RESPA, TILA requires that a Good Faith Estimate of the TILA disclosures be given within 3 days of application (in effect, concurrently with the GFE). 15 U.S.C. § 1638(b)(2); Reg. Z § 226.19(a)(2).

[28] HUD proposes that the HUD–1 contain a list of the finance charges that the lender used to calculate the APR. This suggestion does not cure the problems just described. Whether a particular lender violates the finance charge disclosure rules requires an independent review of all of the closing costs, not just those that the lender treated as finance charges. Under the proposal, regulators and consumers would be unable to make that independent review.

[29] The numerous class action lawsuits challenging the payment of yield spread premiums to mortgage brokers is a primary example of consumers who have found they received mortgage loans which were more expensive than they should have.

[30] All closing costs charged by the lender to close the loan would be included in this guarantee. Some expenses would be excluded from the guaranteed closing costs package, such as certain truly optional expenses like owner's title insurance, as well as expenses unrelated to the loan itself like hazard insurance and property taxes.

Assuming that HUD clarifies that "final underwriting" only means *verification* of information provided by the consumer—and requires that all of the credit qualifications of the consumer be approved *prior* to the offer of the GMPA—the GMPA should indicate the minimum requirements the consumer must meet. The GMPA will be based on information provided by the consumer on income, value of home, other assets, and similar information. The preliminary underwriting performed by the lender is based on the consumer's information and the consumer's actual credit status (as determined from credit reports). However, the GMPA will offer contingent of the consumer fitting certain preconditions. For example, rather than a precise statement of the consumer's exact income, a maximum debt-to-income should be sufficient.[31]

SECTION 8 EXEMPTION IS NOT JUSTIFIED WITHOUT A CLEAR GUARANTEE

Unfortunately, the Guaranteed Mortgage Package outlined by HUD in these Proposed Rules *only seems* to be describing a program like this, but the crucial elements of exactly what is promised, and what is left open to later decision—"final underwriting"—are not addressed.

We have long recommended to HUD that it design a form for consumers to use when applying to lenders. Consumers could fill out this form once, and send it along with any other information a particular lender requires to a number of lenders. Each lender would then conduct a credit underwriting of the consumer's application, based on the consumer's *actual* credit, and the information provided by the consumer about income, value of the home, other assets, etc. The GMPA must then be offered to the consumer contingent only upon the lender's verification of the information provided by the consumer. Unless HUD clarifies the meaning of "final underwriting" to mean just this, the entire GMPA has minimal value for consumers—only offering lenders a way of avoiding compliance with Section 8 of RESPA, and virtually all of the important provisions of TILA.

It may be completely unnecessary for HUD to provide an exemption from Section 8 liability to create the incentive in the marketplace to offer the guaranteed interest rate and guaranteed closing costs. There is little in current law that would stop a lender from providing these guarantees now. We do agree with HUD's principle that removing the barrier of Section 8's prohibition of volume-based discounts would allow lenders to shop for settlement services and thus reduce costs. However, HUD can remove the barrier this places on the marketplace without creating the problems that will result from the exemptions from RESPA and TILA. All HUD need do is remove the current regulatory barrier for volume-based discounts by requiring that the average value of volume-based discounts be passed along to consumers. This seems a far simpler solution than the current construct for the GMPA.[32]

LENDER'S BREACH OF THE GMPA PROMISE MUST CREATE A PRESUMPTION THAT SECTION 8 HAS BEEN VIOLATED

HUD must effectively hold lenders to the promises made in the GMPA. It is completely ineffective to provide that a lender's failure to keep the undertakings made in the GMPA simply causes the lender to lose the exemption from Section 8. *If the GMPA is not abided by, the consumer has no way of determining whether a Section 8 violation has occurred, and no way of alleging one in a legal complaint.* HUD must provide that a lender's failure to keep the promises made in the GMPA to the consumer results in a *presumption* of a violation of Section 8.

Requirements For Yield Spread Premiums Must Be Tighter

HUD has made good recommendations on how to deal with the cantankerous issue of lender payments to mortgage brokers. The Proposed Rule would amend 24 CFR § 3500.7, to add a new subsection (d)(5) requiring that all yield spread pre-

[31] For example, if the consumer provides information indicating annual income of $70,000 a year, and the terms of the loan offered in the GMPA require annual income of $60,000, the GMPA should state this. So if this consumer actually had annual income of $69,000, the GMPA should still be valid. If the consumer's information turns out to be incorrect in a *de minimus* amount, that should not alleviate the lender's obligations under the GMPA.

[32] Indeed, it seems quite likely that HUD need do nothing to facilitate this type of guarantee and fixed price or closing costs. At least one large lender—ABN AMRO—has been providing this product quite successfully for some time. This lender is providing the product, with all the guarantees that we advocate (guarantee of the interest rate, as well as points and closing costs) and is doing it without the exemption from Section 8 liability, and with full compliance with the Truth in Lending Act. *See www.mortgage.com.* Indeed, according to one commentator, several other large lenders are now providing the same type of guaranteed packages, also without requiring a change in the law. *See,* Ken Harney, *Bundled Settlement Fees Attracting Rate Shoppers, The Washington Post,* Real Estate Section, February 10, 2003. *www.washingtonpost.com/wp-dyn/articles/A8995–2003Feb14.html.*

miums paid by the lender must be disclosed in the GFE as a payment to the borrower. This is very helpful to consumers—as far as it goes. However, this Proposed Rule change is a significant benefit to the borrower which must be included, not only in that section of the Rules relating to disclosures, but also in the substantive protections of the regulations interpreting RESPA's Section 8,[33] that is, in 24 CFR § 3500.14. Otherwise, there will be a change in form without any real enforcement, somewhat nullifying the value of the change.

HUD's Proposed Rule on the treatment of yield spread premiums would be far effective if it were *not* couched entirely in the context of a disclosure. There is no private right of action under RESPA for violating its disclosure provisions.

Consumers who do business with mortgage brokers generally have the understanding that the brokers will provide them the loan at the lowest rate that the broker finds for them.[34] Consumers have generally understood and agreed to a specific broker's fee to be paid directly by them—either in cash or by borrowing more—to the mortgage broker to compensate the broker for obtaining the loan. What consumers do not understand, and have not agreed to, is the mortgage broker receiving an additional fee from the lender. Extensive academic analysis has proven this observation to be true.[35]

To date, yield spread premiums are generally paid by the lender to the broker solely in compensation for the higher rate loan. In other words, because the broker brings to the lender a loan at a higher rate than the consumer would otherwise qualify the broker is paid a fee, or kickback. These fees are an extra fee that the broker is able to extract from the deal. In most cases, the borrower is not only paying an up-front broker fee, but is also paying a higher interest rate as a result of this kickback. As this practice clearly provides an incentive for brokers to obtain above par loans for consumers, the dynamics of the marketplace closely resemble the marketplace that Congress attempted to control with its passage of RESPA. This is what is going on in the marketplace today, and this is why the Proposed Rule by HUD is so sorely needed.

As the Secretary has indicated, the goal is to change the current practices of allowing yield spread premiums to operate simply to increase the profit of mortgage brokers and lenders while providing little or no benefit to consumers. Given the statements of the Secretary, and the extensive testimony at the 2002 Senate hearings,[36] the lack of correlation between the fees paid to a mortgage broker on a given loan and the amount of work performed by the mortgage brokers on that loan should be an accepted fact at this point. However, for HUD to make the Secretary's promise[37] a reality, several more decisive steps must be taken.

- HUD must *substantively* change the regulations regarding payments of the yield spread premium, not just the sections relating to disclosures.
- Before any payment is made to the broker, the borrower and the mortgage broker must enter into a *binding fee agreement* regarding the total compensation, however denominated, to be paid to the broker.

---

[33] 12 U.S.C. § 2607(a); 24 CFR § 3500.14(b).

[34] The fact that mortgage brokers hold themselves out as representing the consumer to find the best loan for them, and to represent their best interest, should be beyond much dispute at this point. Consider for example, the illustrations published recently in a White Paper by a lender's group: [A] quick Internet search for the phrase "why use a mortgage broker" brings up numerous broker promotions on mortgage broker websites, including the following:

"[We] shop the market for you so you can be assured that you are receiving the best mortgage rates and terms available."

"For us, nothing is more important than making sure you get the best loan in today's fast changing market."

"We will select the best lender from our many sources to provide you with a loan that meets your individual needs."

"Best of all, a mortgage broker can usually save you money because of a variety of loan programs and pricing available to them. A broker will do the 'rate shopping' for you to find the best possible interest rate at the least cost."

Anne Canfield, *The Lending Report—"Mortgage Brokers and Lenders: Understanding the Difference,"* April 1, 2003 at 2.

[35] *See, e.g.,* Statement of Professor Howell E. Jackson, Harvard Law School, before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, January 8, 2002, *available at http://banking.senate.gov/02_01hrg/010802/jackson.htm.*

[36] *See* Hearing on "Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums." January 8, 2002. *http://banking.senate.gov/02_01hrg/010802/index.htm.*

[37] Regarding this new Rule, the Secretary said: "The new policy will make clear that it is illegal for a settlement service provider to mark-up fees when it is making a payment to another settlement service provider, unless it provides additional value to the homebuyer in the process, or when a provider does no work for the fee and charges an unreasonable amount." *See* HUD No. 01–105, October 15, 2002, "Martinez Moves to Protect Homebuyers; Calls for Simplified Mortgage Process."

- The borrower must be offered a choice of how to pay the broker fee, whether in cash, by borrowing more, or by increasing the interest rate and having the lender pay the broker fee.
- This choice should be offered after loan approval but before the settlement.
- The amount the broker is paid must be the same whether paid by the borrower or the lender. The amount paid the broker by the lender reduces, by the exact amount, the amount owed by the borrower to the mortgage broker.
- The total amount paid by borrower and lender must be reasonable compensation for goods, services, and facilities actually provided.

These principles accomplish several things. First, the consumer knows up-front how much the mortgage broker will charge. Second, the consumer is given the opportunity to choose how this payment will be paid. Third, and most importantly, the broker compensation remains the same regardless of method of payment. This point is crucial, because it eliminates any anti-competitive incentive the broker has to place the borrower in a loan with an interest rate greater than that for which the borrower would otherwise qualify. In other words, whether the borrower chooses a below par loan, a par loan, or an above par loan with a yield spread premium, the broker compensation will remain the same. This is not how the system works today and it must be changed.

HUD's current proposal on how to treat yield spread premiums is a variation of these principles. However, as currently configured, they are neither clear enough to offer real protections to consumers, nor are they enforceable by consumers. For example, under the new proposal it is not at all clear how and when the consumer actually exercises the choice of whether to *use* the yield spread premium. The proposed information to be included in the GFE does not necessarily include loan terms which are actually available to the consumer. It is not clear how the consumer should indicate the choice actually made.

We strongly recommend that HUD make good on the Secretary's promises and make the yield spread premium a useable—and enforceable—credit for the consumer. This can best be done by requiring two separate agreements to be executed between the consumer and the broker, one at the beginning of the relationship in which the broker states the total amount of compensation to be received for the loan, and another when the loan has been approved in which the consumer is informed of the various options by which he/she can pay the broker's fee and other closing costs, and the consumer exercises that option.

Because of extensive litigation flowing from the industry's continued refusal to comply with the mandate of RESPA, in 1998, Congress issued a directive to HUD to write a Statement of Policy.[38] Despite the issuance of the 1999 Policy Statement, the industry continued as before—lenders continued to pay broker fees without evaluating either the services provided by the broker or whether the payment of the lender fee reduced the fees otherwise owed by the borrower. Because the benefit to the brokers and lenders was so great (higher fees for brokers, higher interest rates for lenders), the mortgage industry's strategy was to continue its illegal practice, pay off the few individual actions brought against it and mount a massive effort to fight class action cases challenging the payment of these fees, which might actually cost the industry real money and cause the industry to change its behavior.

Despite industry's plan, the Eleventh Circuit ultimately held that consumers could join together in class actions and challenge this activity.[39] The industry reacted strongly to this case *(Culpepper II)* and pushed HUD to save it from class action liability by "clarifying" its policy statement. HUD accepted the invitation and issued its second policy statement on the subject on October 18, 2001. The crux of HUD's "clarification" comes on page 11, with the statement:

> HUD's position is that in order to discern whether a yield spread premium was for goods, facilities, or services under the first part of the HUD test, it is necessary to look at each transaction individually. . . . [21]

In addition, HUD explicitly repudiated the decision in *Culpepper II* and stated its standard to be: The total compensation paid to the broker from any source (not just the lender-paid fee) must be for goods, services, or facilities. Unfortunately, the effect of HUD's 2001 Policy Statement had the intended impact on the payment of lender paid broker fees. Providing the "clarification" of the 1999 Statement as

---

[38] "The conferees expect HUD to work with representatives of industry, Federal agencies, consumer groups, and other interested parties on this policy statement." See the Conference Report on the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999, H.R. Conf. Rep. No. 1050769 at 260 (1998).

[39] *Culpepper* v. *Irwin Mortgage Corp.,* 253 F.3d 1324 (11th Cir. 2001).

sought by the mortgage industry has had the effect of completely eliminating class actions as a form of redress for illegal lender paid broker fees.[40] Now without class actions as a means to litigate the legality of these fees, the industry has no incentive to change its practices or even to comply with a new regulation—because there are insufficient legal resources in this Nation to represent consumers in individual actions involving claims of only a few thousand dollars.

The New Rules For The GFE, While Basically Good, Must Be Tweaked To Be Fully Protective Of Consumers

We applaud the bright line Proposed Rules by HUD to severely limit the gaming currently rampant in the marketplace on closing costs. The GFE should be a true reflection of actually anticipated costs, not an opportunity for lenders to mislead consumers—as it is currently. Lenders who make numerous loans do have the capacity to determine their own charges and those of settlement service providers that they choose and require.

There are a number of significant changes, however, which must be made to the construct of the proposed GFE, for example:

- The language regarding the broker's relationship to the consumer is incorrect in many States and must be deleted.
- The comparison chart on the GFE form should be uniform and reflect actual terms available to the consumer.
- There is no longer any justification to exclude home equity lines from RESPA coverage, so the Rules should require they be covered.
- The disclosures in Section II of the GFE should include critical loan terms such as prepayment penalties and balloon terms.
- The credit from the lender must *not* appear simply as a credit against closing costs, rather it should appear as a cash credit in the 200 series of the HUD–1.

We have provided more detailed information about our recommendations in the comments submitted to HUD.

There Must Be Effective Enforcement Mechanisms For An Originator's Failure To Comply With All Aspects Of These New Rules

Even perfect consumer protection rules will only work in the marketplace if they are enforced in a meaningful way. Lenders must have incentives to comply with the rules. The potential cost of lack of compliance must be greater than the profit. The Proposed Rule does not currently include *any* mechanisms to punish transgressors. The proposal only provides that once the transgression is caught, the remedy is for the lender to provide what was promised all along. This rewards *lack of compliance* because the cost of being caught breaking the rules is the same as compliance. This is frankly absurd. HUD must provide a means to make it cost originators if they violate these rules—or else the rules are virtually meaningless. We propose several specific measures to make the new RESPA Rules meaningful:

- Civil enforcement of each element under the Rule is essential. This includes the requirements for treatment of the yield spread premium, the new Rules for the Good Faith Estimate, as well as for a lender's failure to keep the promises in the GMPA.
- HUD must remove its stated prohibition against enforcing violations of Section 8 through class actions. The 2001 Statement of Policy explicitly requires a court's individual review of each transaction, eliminating the efficient enforcement mechanism of class actions. Once HUD's Proposed Rules provide the new Rules of the road, there is no reason a court cannot evaluate and enforce the yield spread requirements in class reviews—as the only issue will be whether the mortgage broker actually gave the consumer the full benefit of the payment from the lender.
- A lender's failure to follow the Rules for the new Good Faith Estimate must be actionable in some manner, other than merely regulatory enforcement, as regulatory enforcement has shown that it is not sufficient to encourage the industry to comply with the law. As RESPA does not provide a private right of action, HUD can and should articulate that the failure to comply with these Rules is unfair and deceptive. This will enable some private enforcement under State and Federal prohibitions against unfair and deceptive acts and practices.

---

[40] This has been the exact decision of several courts, including *Glover* v. *Standard Fed. Bank,* 283 F.3d 953 (8th Cir. 2002); *Shuetz* v. *Banc One Mortgage Corp.,* 292 F.3d 1004 (9th Cir. 2002); *Heimmermann* v. *First Union Mortgage Corp.,* ____ F.3d ____, 2002 WL 31067330 (11th Cir. September 18, 2002).

- A lender's failure to follow the Rules when offering a GMPA or to close on a loan that does not conform to the GMPA must presumptively violate RESPA's Section 8. The current proposal results in the lender losing its exemption from Section 8 coverage and only allows the consumer a potential contract action against the lender for not keeping the promises in the GMPA. This is completely ineffective. Few consumers will have the means to bring a case to court for the few thousand dollars which would be obtained in a contract action on most failed GMPA's. Also, consumers will not have the means to allege a *prima facie* case of a violation of Section 8 as the GMPA scenario dictates that neither the initial estimate, nor the HUD–1 will provide details on the payments of fees for services provided by third parties. HUD must state that if a lender fails to comply with the promises made in the GMPA, there is a *presumption that the lender has violated Section 8.*

Conclusion

Given the complexities of the mortgage closing process, the potential effect of the changes in RESPA's Rules on predatory lending, we have extensive and detailed concerns on every aspect of HUD's Proposed Rules on RESPA. For a full explanation of all these concerns we respectfully refer you to our comprehensive comments filed with HUD.[41]

We have met several times with the officials from HUD and we appreciate their willingness to hear our concerns and proposals. We remain seriously concerned, however, about the effect of the final changes in the RESPA Rules on the low- and moderate-income homeowners who are already facing massive problems in the mortgage marketplace. We are hopeful, however, that HUD will attend to these issues and not exacerbate the crisis situation facing this Nation's communities.

Thank you for the opportunity to testify today.

PREPARED STATEMENT OF JOHN A. COURSON

PRESIDENT & CHIEF EXECUTIVE OFFICER

CENTRAL PACIFIC MORTGAGE COMPANY, FOLSOM, CALIFORNIA

ON BEHALF OF THE

MORTGAGE BANKERS ASSOCIATION OF AMERICA

APRIL 8, 2003

Good morning, Mr. Chairman and Members of the Committee. My name is John Courson, and I am President and Chief Executive Officer of Central Pacific Mortgage Company, headquartered in Folsom, California. I am also Chairman of the Mortgage Bankers Association of America (MBA),[1] and it is in that capacity that I appear before you today.

I thank you for inviting MBA to participate in the important discussions regarding regulatory reform of the Real Estate Settlement Procedures Act (RESPA). This regulatory reform initiative, as set forth in HUD's recently issued Proposed Rule entitled *"Simplifying and Improving the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers,"*[2] will have far-reaching import for our industry and on the American consumer.

I begin my presentation by stating that MBA supports Secretary Martinez in his initiatives to simplify and improve the mortgage process, and we believe that the Proposed Rule is a step forward for both consumers and the industry. MBA commends the Secretary on issuing this sweeping proposal. I want to emphasize, however, that although HUD's proposal is bold and far-reaching, it is neither sudden nor rushed. Rather, it is the logical continuation of a mortgage reform initiative that has proceeded, with the involvement of consumer advocates, industry groups, and Government representatives, for over 6 years. And it advances ideas that were well-tested and proven by that process. Moreover, the proposal is critically necessary.

---

[41] These comments are available on NCLC's website at *www.consumerlaw.org.*

[1] MBA is the premier trade association representing the real estate finance industry. Headquartered in Washington, DC, the Association works to ensure the continued strength of the Nation's residential and commercial real estate markets, to expand homeownership prospects through increased affordability, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate professionals through a wide range of educational programs and technical publications. Its membership of approximately 2,600 companies includes all elements of real estate finance: Mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies, and others in the mortgage lending field.

[2] 67 F.R. 49134 (Proposed Rule).

Secretary Martinez has taken on this very complex and politically controversial issue because he recognizes that there is a dire need to modernize a mortgage shopping system based on laws written 30 years ago. Simply put, the act of obtaining home finance has become much too confusing and complex. There is a real need to thoroughly reform this process in order to ensure the objectives of clear disclosures and consumer protection in the settlement process.

The sheer scope of HUD's proposal demonstrates a great deal of leadership and courage by the Secretary. This reform initiative also demonstrates foresight on the part of HUD, as it brings real solutions to the table, and challenges us all to come together and reach agreement on fixing a mortgage disclosure system that has become increasingly complex and burdensome for all the parties involved.

MBA Position

The MBA has consistently supported fundamental reforms to the bewildering and confusing mortgage shopping process. In this respect, this Association has been a constant partner in discussions with Government and consumer groups to craft workable methods to simplify and improve the mortgage process.

MBA sees HUD's Proposed Rule as a unique opportunity to effect large portions of long-discussed improvements to the mortgage process. As can be expected with any far-reaching project to improve existing systems, we believe that there are issues that require significant attention and discussion before the Rule is finalized. Notwithstanding these details, we want to make clear to the Senate Banking Committee that MBA fully embraces the more important concepts of reform advanced by HUD's Proposed Rule. MBA believes that, if properly structured, HUD's "Guaranteed Mortgage Package" system will improve and simplify disclosures, foster market competition, and strongly enhance protections for all consumers.

The Current System

To properly appreciate the benefits of the reform proposals now advanced by Secretary Mel Martinez, it is necessary to understand how the current home mortgage disclosure system operates and why it has been criticized as flawed and ineffective in adequately protecting mortgage shoppers.

Disclosures

The Congressional intent in enacting RESPA was to protect consumers from unnecessarily high settlement costs by affording them with greater and more timely information regarding the nature and costs of the settlement process, and by prohibiting certain business practices. The statute sets out to achieve these goals through two principal disclosures—the Good Faith Estimate of settlement costs (GFE) and the settlement statement (HUD–1). The GFE provides consumers with an itemized estimate of the costs the consumer will be required to pay at closing. This disclosure, containing such items as fees for origination, surveys, appraisal, credit report, etc., must be given to consumers within three business days of application for a mortgage loan. The second key disclosure, the HUD–1, is provided to the consumer at closing, and lists all actual costs paid at, or in connection with, the settlement.

From a consumer's perspective, these forms may be effective in alerting them to the generally anticipated costs they will have to incur at settlement, but the disclosures fall well short of providing them with reliable figures that they need in order to effectively shop the market. As its name implies, the "Good Faith Estimate" requires that cost disclosures to consumers be made in good faith, and that they bear a "reasonable relationship" to actual charges. RESPA does not impose any liability on the creditor for an inaccurate or incomplete estimate, nor for failing to provide one at all. It is important to understand the reality of the current law—the figures disclosed on the GFE, the key disclosure that consumers use to shop for settlement services, are neither firm nor guaranteed. If a consumer discovers that the cost estimates they received at application differ significantly from the final HUD–1 figures, they have no redress or Federal remedy to address the inaccuracies.

MBA believes that this legal structure is entirely inappropriate for both consumers and industry. Consumers who shop the market for the best prices available can never be assured of the actual costs at settlement. This system also provides little incentive for creditors and others to increase accuracy or incur risks in order to ensure such accuracy. In fact, it is unscrupulous actors who benefit, as bait and switch tactics cannot be detected, and the intentional underestimating of costs and fees actually bears rewards in the current marketplace.

A further criticism of current disclosures centers on their complexity. Under existing regulations, the GFE and HUD–1 forms must separately itemize every single charge associated with closing. Though the intent is noble, this requirement creates

a massively complex form that hurls disparate and obscure figures at consumers in a way that they cannot comprehend or effectively use to shop.[3]

From the industry's perspective, these disclosures are burdensome and expensive to administer. Not only are the forms costly to produce, but more importantly, they are subject to varying interpretations by different jurisdictions and regulatory entities. Creditors are always uncertain as to what degree of itemization is required, how certain costs are to be disclosed in instances where the services are outsourced, and what line items to use in instances of nontraditional transactions that require special services. This is exacerbated by the fact that closing requirements vary across State lines, thereby causing disclosure requirements to vary in order to accommodate for such differences. Often, local jurisdictions create disclosure requirements that are in direct contradiction to Federal guidelines.

Section 8

There are further difficulties that arise in connection with the restrictions found under Section 8 of RESPA. This portion of the statute prohibits kickbacks, fee-splitting, fees for referrals of "settlement service business," and unearned fees, and imposes very heavy monetary and criminal penalties for violations of strictures. MBA believes the anti-steering and anti-referral fee provisions of Section 8 of RESPA serve very legitimate consumer protection purposes, because they shield home shoppers from improper influences that hamper shopping and competition, and serve only to inflate settlement prices. As such, the fee provisions should not be eliminated or watered down unnecessarily. However, RESPA's Section 8 provisions are also vague and subject to varying interpretations that impose barriers to cost-saving arrangements. For example, any attempt by lenders to negotiate for better prices with third-party settlement service providers, or efforts to regularize costs through average-cost pricing, could be deemed to constitute violations of Section 8.

I must note that all of the disclosure and legal complexities I describe here frequently lead to expensive and baseless class action litigation. Conflicting advisory opinions emanating from regulators can create classes of plaintiffs based on one or another of the varying interpretations. Special mortgage products that lower costs and benefit consumers create uncertainties under the ambiguous application of the RESPA statute. The Internet is fast becoming the dominant medium for commerce, and yet the anti-kickback provisions of RESPA have not yet been clarified vis-à-vis online transactions. All these legal risks are menacing to industry, and generate massive legal and regulatory costs that, in the end, are passed on to consumers through higher prices.

Need For Change

Although we can all agree that the American home finance system is recognized as the best and most efficient in the world, we cannot ignore the fact that consumer confusion persists and that the mortgage settlement process is bewildering to most home shoppers. The problems outlined above are real and have the effect of raising costs and stifling true competition in the marketplace. Worse still, in many instances, the confusion created by the current labyrinth of forms and disclosures allows unscrupulous actors to dupe and defraud even the most careful consumer. We believe, and repeat here today, that the scourge of "predatory lending" is in large part caused by the complex disclosure laws that allow dishonest players to deceive unwary consumers.

Mr. Chairman, we can do better, and through this Proposed Rule, HUD has provided us with the blueprint from which to start our reform efforts. Perhaps HUD's proposal suffers from certain missing elements or requires certain tweaks and improvements. Overall, however, the proposal presents us with an enhanced consumer protection system that we should strive to perfect rather than destroy.

HUD's Proposal

The Department's Proposed Rule, issued on July 19, 2002, contains far-reaching proposals that could fix virtually all the market and consumer problems I have identified above. The central element of HUD's proposal focuses on the creation of a carefully defined safe harbor that produces greater clarity and increased reliability for the shopping consumer. Under HUD's Proposed Rule, lenders and other settlement service providers would be allowed the option of offering applicants a "guaranteed" fee package in lieu of a GFE. This guarantee, dubbed the "Guaranteed Mortgage Package" (GMP) under the proposal, would require a single lump-sum amount

[3] For example, some of the fees required to be listed on the GFE may constitute costs that are already included and built into the loan's interest rate. Others may be fees that are dependent on the loan amount or price of the property.

that represents the total of those costs expected to be incurred in connection with the originating, processing, underwriting, and funding of that loan. As an important element of the GMP system, HUD is requiring that entities engaging in packaging offer to consumers, within 3 days of a loan application, an "interest rate guarantee," subject to change resulting only from a change in an "observable and verifiable index" or based on other appropriate data or means to ensure the guarantee. To encourage shopping, the proposal would not allow lenders to collect any application fees (prior to consumer acceptance of the GMP offer). Under the proposal, any person who assembles and offers such a package or whose services are included in such a package would be exempt from the restrictions and prohibitions of Section 8 of RESPA relating to mark-ups, volume discounts, and fee splitting.

The Concept of "Packaging"

MBA believes, and has long advocated, that the "guaranteed fee package system" of the type set forth by HUD is the most effective way to achieve accurate disclosures for consumers. The effectiveness of this system is premised on the reality that consumers do not generally shop for individual settlement services, such as appraisal and credit reporting services. Rather, consumers shop for the mortgage loan, which is the central element that in turn requires the purchase of the other ancillary services. Because each lender has different loan products, and because each lender has different investors that impose different requirements pertaining to such services, these ancillary services can rarely be purchased independently from the mortgage loan. As they advance through the mortgage shopping process, consumers tend to focus only on the mortgage loan, and are therefore interested in the overall "price" of the loan itself rather than the individual price for those ancillary services performed for the benefit of the creditor or the ultimate investor.

The "packaging" system recognizes this reality, and constructs a system whereby the consumer is presented with a single price that includes all items required to close the loan. The "packaging" system streamlines cost disclosures to consumers by assembling practically all required closing costs under one single figure, thereby allowing consumers to better understand the overall cost of the loan transaction. Unlike the estimates provided under the GFE, the "package" price offered to consumers would be solid and guaranteed very early in the shopping process. This cost reliability allows consumers to shop the market and effectively compare total settlement service prices among various sources. In short, the "packaging" system engenders market competition by encouraging comparison-shopping, which in turn allows market forces to influence costs and reduce unnecessary fees and charges.

Under a "packaging" system, consumers would receive an up-front disclosure guaranteeing costs relating to settlement. Packaging entities would therefore have an incentive to attain the best prices available in order to ensure the competitiveness of their packages. In a competitive environment, any price reduction achieved by the packager will surely be passed on to consumers.

The "packaging" system envisions a system that is free from unnecessary legal entanglements in terms of deals and activities necessary to arrive at the lowest possible guaranteed fee package. For example, the concept of "packaging" would create market incentives whereby the lenders and other entities will seek out third-party settlement service providers in order to enter into volume-based contracts and otherwise secure discounts from providers in order to ultimately produce much lower settlement costs for consumers. It also envisions that lenders will be able to solidify prices for consumers by "averaging" costs over a large number of transactions. As set forth above, today, these types of activities pose real risks under the hazy rules of Section 8 of RESPA. Average-cost pricing and volume-based compensation could be deemed to constitute improper referral schemes or "overcharges," which some would interpret as being in violation of current RESPA Rules.

Not only do these current restrictions pose undue complexities and legal risk, but also more importantly, they are outdated and unnecessary under a guaranteed cost system. Within the package of guaranteed costs, consumers are fully protected because engaging in certain activities prohibited under Section 8 of RESPA would only serve to inflate the total "package" price, which in turn, would lead consumers to reject inflated-priced products for lesser-priced alternatives. The "packaging" system creates, therefore, a self-enforcing disclosure regime that saves Government resources, promotes competition, and facilitates market innovation. The protections afforded by Section 8 should, however, remain fully applicable outside of the "package" arrangement, as the reality is that improper steering activities would continue to have deleterious effects on market competition and consumer choice.

The Proposed Rule

Through the GMP proposal, HUD is attempting to incorporate this competitive "packaging" system, along with all of its benefits, into the current RESPA regulatory structure. As noted above, the Proposed Rule would afford a Section 8 exemption for entities that are willing to offer simplified disclosures to consumers. These improved disclosures must set forth a guaranteed cost for those services required to close a mortgage loan, along with an assured interest rate quote on the loan.

MBA believes that HUD's proposed guaranteed fee package proposal goes a long way in resolving most of the shortcomings and market failures associated with RESPA's current disclosure system. Under the proposal, HUD would allow "packagers" to replace the current GFE forms with an alternative "Guaranteed Mortgage Package Agreement" disclosure that streamlines the cost disclosures and presents closing costs to consumers as a lump-sum, fixed number that can be easily compared with other packaged products. This disclosure is provided to the mortgage shopper free of charge and very early in the loan application process, thereby encouraging comparison-shopping.

More importantly, HUD's proposal would require that the lump-sum package cost be absolutely guaranteed 3 days after application. For numerous reasons, this represents a very significant consumer protection provision. First, it allows consumers to shop the market with the confidence that they are comparing actual, final figures. Since the Guaranteed Mortgage Package price incorporates practically all costs required to close the loan, the consumer's comparison shopping will not be clouded or confused with meaningless numbers. In addition, the "Guaranteed Mortgage Package Agreement" empowers the consumer to easily detect misdisclosures and effectively enforce their rights and benefits in the bargain. Unlike the current system that allows for variances between the GFE and the HUD–1, HUD's proposed system imposes a "zero" tolerance on the initial and final disclosures; a mere inspection and comparison between the initial disclosure and the closing statement will suffice to clearly expose whether the costs were improperly inflated. The streamlining also eases enforcement for Government regulators, and will make it much tougher to defraud the public.

MBA also believes that HUD's proposals are a step in the right direction in terms of clarifying confusing legal standards that breed pointless class action litigation. The convoluted rules of Section 8 of RESPA are rendered obsolete by using free market forces to compress prices and allowing firm and reliable disclosures to serve as the consumer's shield of protection. Likewise, disclosure difficulties are resolved through a straightforward lump-sum disclosure that incorporates practically all transaction fees, without the complex distinctions that exist today.

We point out that HUD is now being inundated with a number of alternatives to the GMP system. In particular, some groups are advancing a novel "dual" package proposal. In short, this alternative purports to improve consumer shopping by subdividing the GMP into two separate bundles carrying separate timing requirements for the delivery of two, or perhaps three, varying disclosure forms. Under this proposal, ancillary mortgage services would be separated into settlement-related fees, and loan-related fees. In contrast to the much-discussed "one-package" system that HUD has adopted, this new proposal is mired by legal doubt and utterly fails to achieve the simplification objectives that form the basis for this regulatory effort. Under this new scheme, consumers would never see one full set of costs for shopping, and would depend on various sources and receive different disclosures to be able to engage in cost comparisons. We submit that these counter-proposals are an attempt to steer our focus away from the urgent task of reforming the mortgage shopping process for all consumers.

Finally, as currently written, HUD's Proposed Rule goes to great lengths to foreclose the possibility of improper steering arrangements outside of the protective boundaries of the GMP system. Under the Proposed Rule, parties that are not providing services in the transaction would be prohibited from collecting fees or from receiving compensation for improperly steering consumers. MBA is in accord with these protective conditions, and believes that HUD should provide further clarity to the language of the Rule to make absolutely certain that consumer protections are not diluted through sham or fraudulent packaging arrangements that do not meet the spirit of the law.

Summary

MBA believes that, with adjustments, HUD's guaranteed cost "packaging" proposal is a viable system that will deliver broad consumer benefits. The certainty and reliability inherent in this system will provide sound consumer protections while sharply stimulating market competition. In terms of industry benefits, the proposed system will go a long way in clarifying difficult rules and regulations that pose un-

necessary legal risks and serve to trump operational efficiencies that could streamline the mortgage process.

Addendum: Additional Recommendations

Although the MBA embraces HUD's Guaranteed Mortgage Package proposals, we believe that HUD must clarify and revisit certain components of the Proposed Rule. The MBA has filed lengthy comments with HUD, setting out many of these recommendations in detail. For the benefit of the Committee, I summarize the more important ones below:

Interest Rate "Guarantee"

In the Proposed Rule, HUD is proposing that entities engaging in packaging offer to consumers, within 3 business days of a loan application, an "interest rate guarantee, subject to change (prior to borrower lock-in) resulting only from a change in an observable and verifiable index or based on other appropriate data or means to ensure the guarantee." Through this requirement, HUD seeks to ensure that the rate of the loan does not vary after the borrower commits to a packager for reasons other than an increase in the cost of funds. The objective of the interest rate disclosure proposal, as articulated by HUD, is to protect against an increase in the packager's compensation through changes in the rate portion of the price quote.

Although MBA fully supports the Department's objectives with regard to the "Interest Rate Guarantee," we point out that any such regulatory plan must take into account that interest rate movements are set by open market forces that are not under any one lender's control. It must also be recognized that loan pricing is not exclusively influenced, nor fully measured, solely by the movement of any one index. Indeed, any index, even if applicable to pricing a mortgage product, may be only one in a number of components used to determine the ultimate price of a loan. Factors other than "interest rate index" fluctuations that would affect pricing include internal operating costs, product availability, capped investor commitments on particular loan programs, warehouse-line capacity and general capacity. In light of the unpredictability and shifting nature of the factors that affect loan pricing, our members believe that the protections sought by HUD can be afforded only under very specific conditions that allow financial institutions to effectively protect against financial risk. These carefully circumscribed conditions must be incorporated into any Final Rule. They are as follows:

- GMP interest rate "guarantee" should be renamed to reflect more accurately the nature of the disclosure.
- Retain the current definition of "application" under the RESPA regulations.
- Limit the post-disclosure shopping period to 5 days (or any additional period as determined only by the individual lender).
- Once the consumer accepts the GMP offer and "locks" the rate, the disclosed interest rate quote (subject to the index) is good only for as long as the duration of the "lock-in" period.
- GMP disclosure must list the specific loan product, and the "guarantee" would be applicable only to the specified product.
- Lenders must have full authority to select the appropriate rate "index."
- Lenders must have full authority to select different "indices" for different loan products.
- Lenders must have full authority in setting the "spreads" applicable to the interest rate quotes.
- Lenders must be afforded the option of regularly publishing their rates as an alternative means of complying with the GMP rate quote requirement.

Modifications to Good Faith Estimate

For numerous reasons, HUD should delay the implementation of the Revised Good Faith Estimate (GFE) proposals. As currently drafted, these proposals are extremely complex and in our opinion unnecessary in light of the extraordinary proconsumer reforms advanced under the GMPA proposal. We are, therefore, asking that changes to the GFE be delayed until after the market has had an opportunity to accommodate the packaging reforms. After a reasonable period of implementation, HUD should revisit the need for any additional changes to the current GFE system.

Notwithstanding our position to delay the implementation of the Revised GFE, MBA agrees with HUD that confusion regarding mortgage broker compensation continues to be a vexing issue for consumers and that greater disclosure regarding broker fees may be necessary. MBA therefore recommends that HUD adopt the Mortgage Broker Fee Agreement Disclosure already introduced by a coalition of

trade associations to HUD a few months ago, with the attendant exemption for brokers and lenders from Section 8 scrutiny. This additional disclosure would achieve HUD's goals of full disclosure and greater consumer education.

Preemption

HUD should clearly announce its intent to seek preemption of State laws that conflicts with the provisions established by any Final Rule. HUD should also take immediate action to facilitate this preemption of State law.

Conflicts With Federal Laws

MBA has recommended that HUD address the conflicts with other Federal laws that will result from this Proposed Rule. Particularly, HUD should engage the Federal Reserve Board on the implications this Proposed Rule will have with regard to the Truth in Lending Act (TILA) and Regulation Z. The technical requirements contained in TILA, give rise to several conflicts between that law and the proposed regulations. Since some of these requirements have a statutory basis, Congressional action may be required to ultimately resolve this matter.

Protecting Consumers From Improper Steering

Certain HUD issuances regarding this Proposed Rule have given rise to concerns that the GMP proposal could result in the legitimizing of referral fee payments to entities outside of the Guaranteed Mortgage Package, thereby facilitating conflicts of interests, improper steering of consumers, and coercion for kickbacks. MBA believes that any Final Rule issued by HUD must provide further clarity regarding "shell" packaging arrangements in order to foreclose any possibility of improper arrangements that do not meet the spirit of the law.

PREPARED STATEMENT OF NEILL FENDLY

GOVERNMENT AFFAIRS CHAIRMAN & PAST PRESIDENT
NATIONAL ASSOCIATION OF MORTGAGE BROKERS
APRIL 8, 2003

Chairman Shelby, Senator Sarbanes, and Members of the Committee, I am Neill Fendly, Government Affairs Committee Chairman and the Past President of the National Association of Mortgage Brokers (NAMB). I appreciate the opportunity to present to you today NAMB's views on the impact the Department of Housing and Urban Development's (HUD) Proposed Rule (the Proposed Rule) amending the implementing regulations of the Real Estate Settlement Procedures Act (RESPA) will have on small businesses, particularly mortgage brokers, as well as consumers.[1] NAMB[2] is the Nation's largest organization exclusively representing the interests of the mortgage brokerage industry and has more than 15,000 members. NAMB also represents mortgage brokers in all 50 States, as well as the District of Columbia. NAMB provides education, certification, industry representation, and publications for the mortgage broker industry. NAMB has also created an education program for consumers on the homebuying process. NAMB members subscribe to a strict code of ethics and a set of best business practices that promote integrity, confidentiality, and above all, the highest levels of professional service to the consumer.

A mortgage broker is an independent real estate financing professional who specializes in the origination of residential and/or commercial mortgages. A mortgage broker is also an independent contractor who markets and originates loans offered by multiple wholesale lenders. As a result, mortgage brokers offer consumers more choices in loan programs and products than a traditional mortgage lender. Mortgage brokers offer consumers superior expertise and assistance in getting through the complicated loan process. Mortgage brokers also provide lenders a nationwide product distribution channel that is much less expensive than traditional lender retail branch operations (bricks and mortar).

Today, mortgage brokers originate more than 60 percent of all residential mortgages.[3] They are vital members of their communities, often operating in areas

[1] "Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process for Obtaining Mortgages to Reduce Settlement Costs to Consumers," U.S. Department of Housing and Urban Development, Docket Number: FR–4727–P–01, July 29, 2002.
[2] NAMB is a member of the National Federation of Independent Business.
[3] "Economic Analysis and Initial Regulatory Flexibility Analysis for RESPA Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages to Reduce Settlement Costs to Con-
Continued

where traditional mortgage lenders do not, such as rural communities. The average mortgage broker shop consists of only one office and five employees, including the owner.[4] Mortgage broker shops are typically small businesses, which remain a vibrant part of our Nation's economy.

Mortgage brokers are the key to bridging the gap in minority homeownership. A recent study performed by Wholesale Access, a research, advisory, and publishing company, on minority lending stated that two of the key findings of this research are: "(i) brokers reach more minorities than lenders; and (ii) the explanation for this is found in their locations, products, and staffing."[5]

HUD's Proposed Rule

NAMB believes HUD's Proposed Rule will adversely impact homeownership and the economy. NAMB has serious concerns regarding this impact. NAMB finds the economic analysis HUD used to formulate the Proposed Rule and the regulatory burden documents prepared by HUD to be flawed, inconsistent, and dubious at best.[6] NAMB believes the Proposed Rule creates an unlevel playing field in the marketplace for small businesses (particularly mortgage brokers), limits consumer choice and access to credit, and is unworkable in the real world. HUD's Proposed Rule would significantly reduce small business revenue while substantially increasing the regulatory burden on small business. If the Proposed Rule is finalized in its current form, many small businesses involved in the mortgage industry, will no longer be in business, including mortgage brokers. NAMB believes HUD's Proposed Rule will further confuse consumers while placing a disproportionate burden on small business—a fact that HUD even admits in their Economic Analysis.[7] The burden on small business will not be without consequences—the impact will likely result in an increase in costs to consumers and limit consumer access to the range of mortgage products and choices available to them today.

While HUD continues to assert that their Proposed Rule will simplify and improve the mortgage process, many market participants disagree. In fact, HUD received over 40,000 comment letters expressing concern about the merits of HUD's Proposed Rule—the most comment letters HUD has ever received on a Proposed Rule. Concerns about HUD's Proposed Rule are warranted considering the effect the Proposed Rule will have on small businesses and consumers.

NAMB's Concerns With HUD's Proposed Rule:
Enhanced Good Faith Estimate

HUD's Proposed Rule recharacterizes a yield spread premium as a "lender payment to the borrower for a higher interest rate." This characterization creates unintended consequences and provides less clarity to consumers than as presently disclosed. The recharacterization is also inconsistent with two of HUD's Statements of Policy 1999–1 and 2001–1. In HUD's Statement of Policy 1999–1, HUD stated, "The Department recognized that some of the goods or facilities actually furnished or services actually performed by the broker in originating a loan are 'for' *the lender* [emphasis added] and other goods or facilities actually furnished or services actually performed are 'for' the borrower."[8] And HUD reemphasized these statements in its Statement of Policy 2001–1.[9] Further, in the Proposed Rule, HUD stated that, "As retailers, brokers also provide the borrower *and lender* [emphasis added] with goods and facilities such as reports, equipment, and office space to carry out retail functions."[10]

Yield spread premiums are used to pay the costs incurred in connection with a mortgage broker's business. Mortgage lenders save millions of dollars in facilities and employee costs by originating loans through mortgage brokers. However, these costs do not entirely disappear for the mortgage broker—a mortgage broker must pay for its employees, office facilities, and basic operations. By characterizing the yield spread premium as a "lender payment to the borrower," HUD has discounted

sumers," U.S. Department of Housing and Urban Development, Office of Policy Development and Research, July 2002, p. 12.

[4] *Id.*

[5] Press Release, Wholesale Access, Study of Minority Lending Completed, (September 24, 2002) *(www.wholesaleaccess.com).*

[6] *See Attachment 1 [All submitted Attachments held in Committee files.],* "Discrepancies with HUD's Economic Analysis."

[7] "Economic Analysis" at p. vii.

[8] Real Estate Settlement Procedures Act, Statement of Policy 1999–1, 64 Fed. Reg. 10,080, 10,086 (March 1, 1999).

[9] Real Estate Settlement Procedures Act, Statement of Policy 2001–1, 66 Fed. Reg. 53,052, 53,055 (October 18, 2001).

[10] Real Estate Settlement Procedures Act, 67 Fed. Reg., 49,134, 49,140 (July 29, 2002).

any payment to the broker by the lender for goods or facilities actually furnished or services actually performed for the lender and in effect, artificially trying to redefine a market reality.

NAMB believes that HUD has provided no evidence that their recharacterization of a yield spread premium will benefit the consumer by simplifying the mortgage process. Rather, this recharacterization will further confuse consumers and potentially lead them to choose mortgage products because they "appear" less expensive. The Federal Trade Commission has expressed similar concerns. In their comment letter to HUD, the FTC states that the "approach to the disclosure of broker compensation" contained in the proposal could "confuse consumers and lead them to misinterpret the overall cost of a transaction." [11] Further, the FTC states in its comment letter that, "If the additional information or revised formats confuse consumers, the proposed changes may not increase consumer welfare as much as HUD intends and, in the worst case, may actually result in consumer harm." [12] Consumers should not suffer the consequences of a proposal that will steer them to loans that appear less expensive but in reality are more expensive, thus increasing the costs for consumers for homeownership. If the homebuying process is complicated further, which will be the effect of HUD's Proposed Rule, families may be deterred from seeking the goal of homeownership—an outcome that neither the mortgage industry nor consumers want.

NAMB has a long history of supporting the reform of mortgage laws, as the laws are often complex for both consumers and industry. As such, NAMB has spent countless hours and resources to strengthen, simplify, and clarify the disclosure of costs provided to consumers in advance of settlement. NAMB submitted an alternative disclosure form set forth in its comment letter that satisfies HUD's objectives to simplify and clarify the disclosure of settlement costs, but not at the expense of small business or to the detriment of consumers.[13] It will allow the consumer to perform a true "apples-to-apples" comparison of the cost of the mortgage while maintaining a more level playing field for mortgage originators.

The Proposed Rule is Anti-Competitive

NAMB does not believe RESPA reform should create an unlevel playing field among originators or, in essence, pick winners or losers. Unfortunately, the Proposed Rule does just that. HUD even acknowledges that the Proposed Rule "results in different treatment of compensation in loans originated by lenders and those originated by mortgage brokers." [14] HUD's Proposed Rule requires that only mortgage brokers must include their indirect compensation in the *calculation* of Net Loan Origination Charge, but does not require the same of all originators. This will complicate a consumer's ability to shop because the consumer will be unable to perform a true "apples-to-apples" comparison of the cost of the mortgage. FTC also expressed concern about this disparity. In their comment letter, FTC states that HUD's prominent emphasis of the yield spread premium and the "asymmetric disclosure" of compensation for mortgage brokers might "inadvertently *burden consumers and competition."* [15] Competition fosters choice for consumers and helps to keep prices down for consumers. NAMB believes HUD's Proposed Rule will instead decrease competition, thereby forcing small businesses to close, leaving fewer choices, if any, for consumers.

The effect of the Proposed Rule prevents mortgage brokers from appearing competitive (such as no longer being able to advertise a "no point" loan).[16] In addition,

[11] Federal Trade Commission Press Release on their Comment Letter.

[12] Comment Letter submitted by the Federal Trade Commission, on the "Real Estate Settlement Procedures Act, Simplifying and Improving the Process for Obtaining Mortgages to Reduce Settlement Costs to Consumers," U.S. Department of Housing and Urban Development, FR–4727–P–01 (July 29, 2002), at p. 1.

[13] *See Attachment 2,* Alternative Disclosure Form submitted by the National Association of Mortgage Brokers, on the "Real Estate Settlement Procedures Act, Simplifying and Improving the Process for Obtaining Mortgages to Reduce Settlement Costs to Consumers," U.S. Department of Housing and Urban Development, FR–4727–P–01 (July 29, 2002).

[14] Real Estate Settlement Procedures Act, 67 Fed. Reg. 49,134, 49,148 (July 29, 2002).

[15] FTC Comment Letter at p. 10.

[16] If the proposed characterization of yield spread premiums is implemented, mortgage brokers will be placed at a competitive disadvantage. One example of this is that mortgage brokers will not be able to advertise certain mortgage loans and remain competitive. For example, a mortgage *broker* who makes a "no point" mortgage loan at 7 percent interest rate on a $100,000 loan, but collects a $1,000 yield spread premium, must advertise that this is a one-point mortgage loan. A mortgage *lender,* who originates a $100,000 mortgage loan at a 7 percent interest rate, but collects $1,000 in compensation when the loan is sold, can advertise a "no-point" mortgage loan. These are the exact same loans with the exact same costs to the consumer. However, due

Continued

by including a mortgage broker's indirect compensation in the calculation of the Net Loan Origination Charge, consumers will suffer a loss of available credit as many mortgage brokers will no longer be able to originate FHA- and VA-insured mortgage loans. This is because direct originator compensation on these loans is limited to 1 percent of the loan amount (cap) in connection with FHA-insured loans, and direct originator compensation on VA-insured mortgage loans is limited to 1 percent of the total loan amount or closing costs (cap). In characterizing yield spread premiums as a "lender payment to the borrower," indirect compensation to a mortgage broker is artificially transformed into direct compensation and thus subject to the cap. This will impact many first-time homebuyers who rely on the FHA- and VA-insured mortgage loans as a viable financing alternative. Mortgage brokers will no longer be able to provide homebuyers with FHA- and VA-insured loans. This is significant as approximately 31 percent of all FHA-insured loans are originated by mortgage brokers.[17]

Further, under the Proposed Rule, HUD would no longer require a Good Faith Estimate of costs associated with the mortgage loan but rather a guarantee of many of the costs, including many third-party costs, associated with the mortgage loan. Many times during the processing of a mortgage loan, unforeseen costs arise. A good example of this is when the wholesale lender, after the review of the appraisal, requires additional comparables for the property in question. Another example is when, after an appraisal or inspection, damage to the property is discovered and a termite inspection or structural analysis is required. A mortgage broker cannot foresee every cost associated with a mortgage loan. While large lenders might be able to absorb these losses, small businesses like mortgage brokers cannot. Losses such as these can be enough to put mortgage brokers out of business.

NAMB's Concerns With HUD's Proposed Rule: Guaranteed Mortgage Packages

The Proposed Rule also sets up a new process for originating mortgages called the Guaranteed Mortgage Package Agreement (GMPA). Created by regulatory fiat, this regime requires an originator to offer a Guaranteed Mortgage Package (mortgage, third-party settlement services, and closing costs) for a set price. Mortgage brokers, and other small settlement service providers, as small businesses, do not have the bargaining power to enter into volume-based discounts with third-party settlement service providers, as do larger entities. The end result will be additional consolidation in the mortgage industry at the expense of small business and ultimately, the consumer.

The economic burden associated with packaging, will fall disproportionately on small business, and although they understate the costs associated with this burden, even HUD concedes that—"$3.5 billion of the $6.3 billion in transfers to borrowers comes from small originators ($2.2 billion) such as small brokers and small settlement service providers ($1.3 billion)."[18] Since the Proposed Rule significantly increases the regulatory burden for mortgage brokers, a burden that many will not be able to absorb, mortgage brokers will be forced out of the business of placing people in homes—a perverse, but very real effect of a proposal *intended* to actually help put people in homes. Given the mortgage broker's significant involvement in originating mortgages, we firmly believe this Proposed Rule cannot be finalized in its current form.

Under the Proposed Rule, many mortgage brokers will not be able to compete with the larger entities and will be forced out of business, or become a captive agent for only one lender or two utilizing their packages. The mortgage broker will therefore be left with the Enhanced Good Faith Estimate approach, which as stated herein, discriminates against the small business mortgage broker.

Further, it is questionable whether the packaging of settlement services and a mortgage loan will benefit consumers. While some argue that it will create ease in the shopping process, consumers will not be getting a clear picture to enable them to make a sufficient comparison in the packaging world. Under HUD's Proposed Rule, the services performed in the package are not required to be itemized until settlement. Thus, when a consumer receives their GMPA, it will not contain a list

---

to a Federally-regulated mandate (*i.e.,* artificial) the mortgage broker appears more expensive as he or she must advertise that this is a one-point mortgage loan.

[17] Letter from Engram A. Lloyd, Director, Philadelphia Homeownership Center, U.S. Department of Housing and Urban Development, to Paul H. Scheiber, Blank Rome Comiskey & McCauley LLP on August 12, 2002.

[18] "Economic Analysis" at p. vii.

of all services performed as part of the package.[19] A consumer may have two or three GMPA's for comparison purposes but those same three GMPA's may not contain the same services. The "black box" of settlement services created by packaging will not benefit consumers; rather it will only make it more confusing and difficult for consumers to shop.

HUD's Economic Analysis and NAMB's Economic Study

NAMB believes that the Economic Analysis and Initial Regulatory Flexibility Analysis (Economic Analysis) prepared by HUD does not provide a clear picture of the potential impact on a market that is functioning effectively and does not accurately reflect the Proposed Rule's impact on small business. In fact, HUD's Economic Analysis is flawed, incomplete, and inaccurate.

Basing a Proposed Rule on flawed economic analysis will result in a flawed Final Rule that harms consumers and could have devastating repercussions on a housing market that has been one of the only sectors sustaining our economy. NAMB believes that further analysis by HUD is necessary to ensure that any Proposed Rule impacting the housing market is based on a foundation of market realities and not just good intentions.

HUD's failure to accurately analyze the economic impact on small business can be illustrated through their own reported inconsistencies. HUD's Paperwork Reduction Act Submissions to the Office of Management and Budget (OMB) states that annual responses for Good Faith Estimates (GFE's) is 11 million.[20] However, HUD's Economic Analysis states that if the Rule applied in the year 2002, it would impact 19.7 million applications.[21] This is significant because the submission to OMB underestimates the paperwork burden by at least 8.7 million GFE's and an additional $57 million.

In addition, HUD's Economic Analysis states that "originators and closing agents will have to expend some minimal effort in explaining to consumers the cross walk between the enhanced GFE and the more detailed HUD–1."[22] However, HUD did not perform their due diligence to ascertain these costs since the costs were not included in HUD's submission to OMB. The cost associated with explaining to consumers the new streamlined GFE and the more detailed HUD–1 is not "minimal." NAMB believes a detailed and accurate estimate should be provided.

HUD states that the program change being mandated by the Proposed Rule would increase the burden on the industry by 2,530,000 burden hours.[23] HUD has testified that this is a one-time transition burden.[24] NAMB believes that this one-time transition burden that is equal to 289 years will eradicate small businesses in the mortgage industry. The extreme burden HUD's Proposed Rule forces upon small business will not only dismantle small businesses, but it will also alienate consumers from the dream of homeownership.

NAMB's review of the Economic Analysis and its obvious flaws led to NAMB's commission of an economic study on the underlying assumptions of HUD's Economic Analysis, and, among other things, the effect the Proposed Rule would have, if implemented as written, on small businesses.[25] NAMB's study "anticipates that small originators/brokers and small third-party service providers will lose more than 60 percent of their revenue."[26] This is a tremendous loss and will cause many small businesses to close, ultimately resulting in a loss to consumers in their choice and access to credit.

The study also explains "this lost revenue will not go to consumers, however, but is likely to go to larger businesses."[27] The study cites that "on balance, smaller businesses will be driven from the market or driven to join in business or even ownership with larger firms, but the overall benefit to consumers from this concentration

[19] HUD's Proposed Rule does provide that certain services (pest inspection, lender's title insurance, credit report, and/or appraisal) must be shown as "anticipated" if they so are. Real Estate Settlement Procedures Act, 67 Fed. Reg. 49,134, 49,160 (July 29, 2002).

[20] *See Attachment 3,* "Supporting Statement for Paperwork Reduction Act Submissions," U.S. Department of Housing and Urban Development, August 2001, p. 5.

[21] "Economic Analysis" at p. 9.

[22] *Id.* at p. 25.

[23] "Supporting Statement," p. 7.

[24] Senate Banking Committee, "Hearing on Issues Relating to HUD's Proposed Rule on the Real Estate Settlement Procedures Act," March 20, 2003.

[25] *See Attachment 4,* Blalock, Joseph and Tyler Yang, "Analysis and Comments on HUD's RESPA Economic Analysis and Initial Regulatory Flexibility Analysis," IFE Group, February 24, 2003, p. 1.

[26] Blalock at p. 20–21.

[27] Blalock at p. 2.

and reduction in competition is questionable."[28] Unfortunately, when dealing with a housing market that is a driving factor for our economy, such questions should not go unanswered.

The stark reality of business is that the more the mortgage marketplace condenses and consolidates as a result of the Proposed Rule's anti-competitive effect, both in the world of the enhanced GFE and the GMPA, a consumer's access to credit will contract. Consumers will lose the service small business is known for. The end result will be access to less credit for consumers—again, a perverse impact of a Rule that is being implemented to help consumers.

Regulatory Flexibility Act of 1980[29]

NAMB believes the Proposed Rule requires further analysis under the Regulatory Flexibility Act (RFA).[30] When promulgating proposed and Final Rules, the RFA requires Federal agencies to review the Rules for their impact on small businesses and consider less burdensome alternatives. Pursuant to the RFA, if a Proposed Rule is expected to have a significant economic impact on a substantial number of small entities, an Initial Regulatory Flexibility Analysis (IRFA) must be prepared.[31]

NAMB does not believe HUD sufficiently complied with the RFA when promulgating their Proposed Rule. HUD's IRFA[32] did not contain a sufficient comparative analysis of alternatives to the Proposed Rule that would minimize the impact on small entities nor did it accurately describe the projected reporting and record keeping requirements and other compliance requirements of the Proposed Rule, including an accurate estimate of the classes of small entities which will be subject to the requirements as required by RFA.

The Small Business Administration Office of Advocacy (SBA), the voice for small business, even expressed concern to HUD regarding their IRFA. Pursuant to SBA's statutory duty to monitor, examine, and report Agency compliance with the RFA, as amended by the Small Business Enforcement Fairness Act of 1996 (SBREFA), the SBA submitted a comment letter encouraging HUD to issue a revised IRFA "that takes into consideration the comments of affected small entities and develops regulatory alternatives to achieve HUD's objectives while minimizing the impact on small business."[33] The SBA recommended that HUD publish a supplemental IRFA to provide small businesses with "sufficient information to determine what impact, if any, the particular proposal will have on its operations" and "provide a meaningful discussion of alternatives that may minimize that impact."[34] NAMB believes it is imperative that HUD issue such an analysis before they issue a Final Rule so that small businesses could get a better understanding of how the Rule will impact their business and ultimately, their ability to serve consumers. Although HUD's Economic Analysis states that \$3.5 billion of the \$6.3 billion (55 percent) in transfers to consumers will come from small businesses,[35] the SBA explained in their comment letter that HUD's Economic Analysis would be improved by a revised IRFA, which *clearly defines the impact on small entities,* instead of citing the mere overall cost to small business.[36] Since HUD did not specifically compute the cost of compliance per small business, HUD could not and did not sufficiently analyze regulatory alternatives as required by RFA that would minimize the burden on small businesses. The National Federation of Independent Business (NFIB) also stated

---

[28] Blalock at p. 2.
[29] 5 U.S.C. § 601 *et seq.*
[30] 5 U.S.C. § 601 *et seq.*
[31] If the Proposed Rule will not significantly impact a substantial number of small entities, the head of an Agency must certify as such and provide factual determination. When an Agency issues a Final Rule, it must prepare a Final Regulatory Flexibility Analysis (FRFA). 5 U.S.C. § 603.
[32] The IRFA must describe the economic impact of the Proposed Rule on small entities including a description of the projected reporting, record keeping and other compliance requirements of the Proposed Rule. It must also contain a comparative analysis of alternatives to the Proposed Rule, which would minimize the impact on small entities and document their effectiveness in achieving the regulatory purpose.
[33] *See Attachment 5,* Comment Letter, Small Business Administration Office of Advocacy, "RESPA: Department of Housing and Urban Development: Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process for Obtaining Mortgages to Reduce Settlement Costs for Consumers; Proposed Rule; Docket Number: FR–4727–P–01," p. 1, October 28, 2002.
[34] SBA Comment Letter at p. 4.
[35] "Economic Analysis" at p. 26.
[36] SBA Comment Letter at p. 3.

that the specifics of the impact on small businesses "were missing from the initial regulatory flexibility analysis." [37]

NAMB finds this very troubling in the sense that small business—particularly in the housing industry today—is one of the few pillars in this economy that has not fallen. NAMB is concerned that arbitrarily reducing small business revenues while substantially increasing the regulatory burden on small business by 2.5 million burden hours will absolutely devastate small business. As a result, consumers will suffer an increase in the cost of credit and a reduction of choice and access to credit.

Conclusion

The NAMB sincerely appreciates the opportunity to share its concerns with this Committee on the impact HUD's Proposed Rule will have on small business and consumers. We commend you, Chairman Shelby, for convening this hearing on this very important issue. NAMB is very concerned that if HUD proceeds to finalize the Proposed Rule in its current form, small businesses will be driven out of business, especially mortgage brokers. As a result, consumers will experience a reduction in the availability and access to credit and homeownership will likely decline as a result. We ask this Committee for its support to request HUD to revise their Proposed Rule so that it accomplishes HUD's stated goals and objectives to simplify the mortgage process and increase homeownership while not creating competitive disadvantages in the marketplace.

PREPARED STATEMENT OF IRA RHEINGOLD

EXECUTIVE DIRECTOR & GENERAL COUNSEL

NATIONAL ASSOCIATION OF CONSUMER ADVOCATES

APRIL 8, 2003

Overview

Mr. Chairman and Members of the Committee, the National Association of Consumer Advocates [1] thanks you for inviting us to testify today about HUD's recent proposed rulemaking regarding the Real Estate Settlement Procedures Act. We offer our testimony here today on behalf of our members and the tens of thousands of consumers they represent.

Last July, the U.S. Department of Housing and Urban Development issued important proposed changes to RESPA regulations that attempt to dramatically alter the way the mortgage lending market operates. Initially, I would like to commend HUD for taking bold action to reform the current RESPA regime that undeniably provides little benefit for consumers. HUD has recognized that changes must be made, and that it is the Agency's responsibility to develop the necessary rules and regulations that will allow this important statute to achieve its purpose of protecting consumers in the mortgage settlement process.

The stated goals and orientation of HUD's Proposed Rule are exactly on target—to protect consumers. We believe that the proposal offers some very positive features that if properly implemented would improve the prime mortgage marketplace for consumers. These positive features include:

Requiring An Interest Rate And Closing Cost Guarantee When A Guaranteed Mortgage Package Agreement Is Offered

Some parts of the mortgage industry are strongly pushing HUD to transform the GMPA into a package of closing costs instead of a package of all closing costs and points and interest rate. In its proposal, HUD has correctly refused to allow a Section 8 exemption for a lender's offer of merely a closing cost package. After all, as HUD has recognized, a lender who offers a guarantee for the closing cost package, without also guaranteeing the points and the rate, has no impediment to simply increasing the points or the rate after the consumer is locked into using the lender because the closing cost package has been purchased.

---

[37] Letter from the National Federation of Independent Business to Secretary Mel Martinez, U.S. Department of Housing and Urban Development, March 7, 2003.

[1] The National Association of Consumer Advocates is a nonprofit organization designed to promote justice for all consumers by maintaining a forum for information sharing among consumer advocates across the country. Our mission is to serve as a voice for consumers in the ongoing struggle to curb unfair and abusive business practices, especially in the areas of finance and of credit.

HUD's Attempt To Recharacterize Yield Spread Premiums As A Payment From The Lender To The Borrower

During the last several years, no issue has been more contentious than the use of yield spread premiums in the home mortgage lending process. Time and again, consumers have unknowingly received a mortgage with a higher interest rate than they had otherwise qualified for because of inappropriate and illegal kickbacks paid by lenders to brokers in the form of yield spread premiums. HUD's proposal to change the way yield spreads are disclosed is an important first step (although much more is needed) in allowing consumers to have greater control in choosing the type and the structure of their loans and in the method to compensate *their* mortgage broker.

HUD's Bright Line Rules Attempt To Make The Good Faith Estimate A Meaningful Binding Document That Provides Real Information To Consumers

Far too often, the Good Faith Estimate offered to consumers barely resembles the loan the borrower ultimately receives. HUD's Proposed Rule attempts to severely limit the bait and switch gaming rampant in the home mortgage marketplace involving closing costs. The GFE should be a true reflection of actually anticipated costs, not an opportunity for lenders to mislead consumers—as it is currently. Lenders who make numerous loans absolutely have the capacity to determine their own charges and those of settlement service providers that they choose and require.

While we strongly appreciate HUD's positive efforts, we nonetheless have several overarching concerns about the Proposed Rule and believe a myriad of important details must be worked through to ensure that the Rule does, in fact, protect consumers, instead of simply providing a shield behind which mortgage originators can hide inappropriate, unfair, and illegal activities. We will use the remainder of our testimony to broadly describe these problems.

Problems With HUD's Proposed Rule

These Rules do not address predatory lending.

As the Secretary has already noted in his testimony to the House Financial Services Committee on October 3, 2002, these Rules do not provide the answer to predatory lending. It is imperative that HUD clarify that this Rule is not designed to address the problem of predatory lending and that other reforms are still needed. Indeed, HUD does not have the authority under RESPA to address predatory lending by itself in a global way. The Rule is intended to facilitate shopping for mortgages and to promote competition. This laudable goal should be pursued. However, as victims of predatory mortgages are targeted by lenders who actively work to eliminate shopping opportunities, no amount of improvement to the RESPA Rules will protect them.

These Rules must avoid facilitating predatory lending.

The Guaranteed Mortgage Package Agreement is a creative and novel proposal that, if implemented properly, will enable mortgage shoppers in certain markets to shop more effectively. However, we must keep in mind that shopping does not actually occur among all consumers—particularly those who are today the victims of predatory mortgages and those who will be targeted in the future. The predatory lending market thrives in an atmosphere in which lenders and brokers target homeowners and experience little pressure to provide the best products. Indeed, the incentives run in the other direction—borrowers are steered to the worst products. The GMPA must not provide a new means for lenders in the subprime market to avoid liability for noncompliance with consumer protection law in that segment of the marketplace that most needs *more* substantive consumer protection.

Because the GMPA proposal eliminates disclosures that otherwise make it possible for consumers and their advocates to evaluate compliance with both the Truth in Lending Act and the Home Ownership and Equity Protection Act, HUD must tread carefully in developing this RESPA Rule and follow two essential principles:

- *Limit the GMPA to the prime market*—As the purpose of the GMPA is to encourage shopping in the open marketplace of competitive mortgage lending, the GMPA should only be provided to that section of the market that is most capable of using competitive pressures in the open marketplace to protect themselves—to the prime market.
- *The GMPA Rule should only be finalized after full coordination with the Federal Reserve Board*—It is crucial that both regulators and consumers be able to determine compliance with TILA and HOEPA simply by looking at the information provided on the documents required by Federal law. Under the current proposal, it

is unclear that this will be the case and HUD must work with FRB to develop a transparent GMPA that allows for this determination to be made.

The substantive change proposed regarding yield spread premiums must be included in the regulations relating to RESPA's Section 8, not just as disclosures.

For yield spread premiums to be what the mortgage industry claims them to be, merely one of several methods consumers can choose to compensate their mortgage brokers (and not an illegal kickback), enforceable regulations must be created that require the following:

- *The consumer must be informed up-front how much the mortgage broker charges.*
- *The consumer must be provided the opportunity to choose how this payment will be paid from choices actually available to the consumer.*

The Good Faith Estimate Proposal Rules, while good in concept, do not sufficiently protect consumers.

This is particularly true of HUD's language describing the mortgage broker's relationship to the consumer. Section I of the proposed GFE allows brokers to describe themselves like this: "We do not offer loans from all funding sources and we cannot guarantee the lowest price or the best terms available in the market. You should compare the prices in the boxes below and shop for the loan originator, mortgage product, and settlement services that best meet your financing needs." Both of these statements must be deleted from the GFE.

In many States, a broker can establish an agency relationship with a borrower through the broker's conduct or by written and oral representations.[2] The broker may have the fiduciary duties of an agent to the borrower, which may include the duty to advise the borrower of disadvantageous loan terms in an offered loan or the duty of loyalty to the borrower that would require the broker to seek out a loan with favorable terms for the borrower. HUD's statement in the GFE therefore conflicts with obligations that may be imposed on brokers under State law. Moreover, this misguided statement will undoubtedly be used, by unscrupulous brokers, to defeat borrower claims that a fiduciary relationship was established or that the broker made misrepresentations about the loan terms or the broker's role.

There must be effective enforcement mechanisms for an originator's failure to comply with all aspects of these new rules.

Even perfect consumer protection rules will only work in the marketplace if they are enforced in a meaningful way. Lenders must have incentives to comply with the rules, because lack of compliance is too costly. The Proposed Rule does not currently include *any* mechanisms to punish transgressors. The proposal only provides that once the transgression is caught, the remedy is for the lender to provide what was promised all along. This rewards *lack of compliance* because the cost of being caught breaking the rules is the same as compliance. For the rules to be effective HUD must allow for civil enforcement of each element under the Rule including the requirements for treatment and disclosure of the yield spread premium, the new rules for the Good Faith Estimate, as well as for a lender's failure to keep the promises in the GMPA. This can be accomplished by:

- Removing HUD's stated prohibition against enforcing violations of Section 8 through class actions. The 2001 Statement of Policy explicitly requires a court's individual review of each transaction, eliminating the efficient enforcement mechanism of class actions. Once HUD's Proposed Rules provide the new Rules of the road, there is no reason a court cannot evaluate and enforce the yield spread requirements in class reviews—and the only issue will be whether the mortgage broker actually gave the consumer the full benefit of the payment from the lender.
- A Statement from HUD articulating its belief that the failure to comply with proposed GFE rules is unfair and deceptive. This should enable some private enforcement under State and Federal prohibitions against unfair and deceptive acts and practices.
- Creating a presumption establishing a lender's failure to follow the rules when offering a GMPA, or its failure to close on a loan that conforms to the GMPA violates RESPA's Section 8.

In summary, while we applaud HUD's positive efforts to reform RESPA, the important detailed changes to their rulemaking must be implemented before HUD's stated goal of simplifying the mortgage market for the benefit of consumers can be achieved.

[2] In addition, some States have passed legislation specifically regulating mortgage brokers and these laws may impose additional disclosure or substantive requirements.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED FROM CHARLES J. KOVALESKI

Q.1.a. You state that "packaging" as described in the Proposed Rule RESPA reform regulation will hurt consumers, because they will not be able to separately shop for title insurance and related services. To what extent does the title industry currently market its services and products directly to consumers?

A.1.a. Several of our member companies have recently engaged in education and advertising campaigns which are designed to reach the consumer, namely Connecticut Attorney's Title and Attorney's Title Insurance Fund, Inc. of Orlando, Florida. These education campaigns do show increased selection of attorneys after education efforts are undertaken. In addition, buyers and sellers of residential real estate may personally shop for these services—and are doing so with increasing frequency through the Internet. They also, in a sale transaction, will look to and rely upon the recommendations of their real estate agent, who is generally much more knowledgeable than the consumer about the services, reputations, and prices of the various providers of these services in the market. Accordingly, title companies also direct significant marketing efforts to bringing their products and services to the attention of these real estate professionals who, in essence, are surrogate shoppers for consumers in helping them to make decisions on providers of title, closing, and escrow services.

The title industry markets extensively to consumers and to their representatives—real estate brokers and agents, attorneys, mortgage lenders, and others who help consumers select a provider of title, closing, and escrow services. (In California and other western States, the closing of a residential real estate transaction is handled through an escrow process, whereby an escrow company, acting under instructions from the seller and the buyer of the property, performs various steps necessary to effectuate the sale (that is, obtaining documents and signatures, receiving funds and making the appropriate payments, filing documents of record)). It must be kept in mind that in the majority of residential real estate transactions in the country, the seller of the property pays for a significant share of the title, closing, and escrow costs, and therefore has a direct interest in the selection of the providers of these services.

Q.1.b. Does the industry have any independently confirmed documentation on how frequently consumers shop for loans and then title services? And if so, please provide the documentation to the Committee.

A.1.b. ALTA does not have any current information on how frequently consumers shop for mortgages at present. Obviously, with the current low mortgage rates, it is common for consumers to refinance as rates decline. A 1997 Gallup poll included the following question which was shared with ALTA. "Did you personally select the title insurance company providing your owner's title coverage?"

Half (48 percent) of the respondents said they personally selected the title insurance company which provided their owner's title coverage. (See attached.)

We expect that the number of consumers shopping for title insurance is now much higher as a result of consumer education and the fact that the recent refinancing boom has resulted in more sophisticated consumers. Also, we note that in many real estate transactions, the contract of sale reflects the agreement of the seller and the buyer as to who they will use for escrow/closing/title services, with the result that the selection of these providers will have been made *before* the buyer begins to look for a mortgage lender to help finance his or her purchase of the property. The assumption in your question is that borrowers first shop for lenders and then afterwards look for providers of escrow/closing/title services. While that will be the case in a refinance transaction (to the extent the consumers shop for title and closing services, rather than accept the choice of the refinancing lender), in transactions involving the purchase and the sale of a home that is not likely to be the order of events.

Again, we reiterate that in purchase/sale transactions, the seller and the buyer have an interest in who is going to provide the escrow/closing/title services for *their* transaction that is quite separate from the interest of the lender in the loan transaction. HUD's packaging approach was based on the loan refinancing paradigm where: (a) the lender and the mortgage loan drives the transaction, (b) the borrower usually has little interest in who provides the services needed by the lender to make and close the loan, and (c) there is no seller in the transaction. Accordingly, HUD's packaging approach fails to recognize how sellers and buyers make decisions in *their* purchase/sale transaction and that the seller, who is frequently paying a significant portion of the costs for these services, has an interest in the selection of the provider of these services.

Q.1.c. If consumers do separately shop for title services, how frequently do consumers run into fees that cannot be shopped at all?

A.1.c. This topic expresses the concern that consumers frequently may find that fees for these services cannot be shopped. To our knowledge, consumers very seldom run into title fees that cannot be shopped. We believe it is inappropriate for us to address the wide variety of lender fees that may appear. Questions on their fees should be addressed to lender representatives. Our fees are in most instances regulated at the State level because we are regulated as insurance products. In addition, the APR does facilitate shopping of fees.

It is true that in a few States, such as Texas, Florida, and Pennsylvania, the State establishes or approves rates for certain title and/or closing services that must be charged by all licensed providers of those services. In those States, there will be no price competition for the services covered by the promulgated or approved rate. However, these rates may not include all title and closing services. Moreover, even though most other States have regimes for the filing of title insurance rates, individual companies may file different rates, and not all title and closing charges are included in those rates. In short, for many of the services provided by title and escrow companies there is not a single, State established or approved rate, and competition will set the level of those charges.

In areas where charges for title, closing, or escrow services are set by competition, shopping among different providers can frequently result in some savings. However, as is the case in highly competitive markets, providers whose prices are higher than the market must inevitably bring their prices down or risk a loss of business. Similarly, parties that seek to increase their market share by lowering their prices, inevitably face the situation that their competitors will meet their prices in order to avoid losing market share.

Finally, in this regard, your question appears to suggest that the only kind of shopping that can be of benefit to consumers is shopping on price. There are, however, other aspects of competition—reliability, quality, and speed of service, convenience, efficiency in handling the closing smoothly—that are also of interest to sellers and buyers in selecting a provider. Because real estate salespersons are involved in so many closing transactions, they tend to be in a far better position than the individual seller or buyer (who has only isolated experiences with these matters) to recognize which escrow and title companies in the market rank high in these regards.

Q.2. I understand from your written testimony that you do not believe HUD should offer a Section 8 safe harbor for the Guaranteed Mortgage Package, because that will permit referral fees between settlement service providers. However, the RESPA statute, as it currently is constituted permits referral fees between title companies and settlement lawyers. Is that safe harbor currently being abused by title companies and settlement lawyers? If so, how is it abused and under what circumstances? If it is not being abused, why do you want to deny such a safe harbor to other settlement providers?

A.2. Your second series of questions appears to suggest that there is some discrepancy between: (a) ALTA's position that HUD should not provide an exemption from the anti-kickback and referral fee provisions of RESPA Section 8 for parties involved in a Guaranteed Mortgage Package, and (b) the provision of the current RESPA statute that you state "permits referral fees between title companies and settlement lawyers."

At the outset, let me clear up a misconception reflected in your question. *There is no provision of the RESPA statute that permits a title company to pay a referral fee to a settlement attorney, or vice versa.* Indeed, the fact that there is no exemption or safe harbor for referral fees paid by title companies to settlement attorneys is vividly demonstrated by a very recent HUD press release (attached hereto) announcing that HUD had reached a settlement with 13 lawyers in New York settling an investigation in which HUD alleged that the lawyers had improperly referred business to title agencies in which they had ownership interests and from which they had received referral fees. As you can see from this HUD release, title companies and attorneys who are parties to referral agreements are clearly subject to RESPA sanctions.

The "safe harbor" you may be referring to that addresses payments between title companies (or other parties) and attorneys is Section 8(c)(1)(A), which provides that nothing in Section 8 "shall be construed as prohibiting . . . the payment of a fee to attorneys

at law for services actually rendered.” This is part of a broader safe harbor that Congress adopted in RESPA Section 8(c)(1)(B) to make clear that payments between settlement service providers that are reasonably related to goods provided or services performed are not prohibited by Section 8. Accordingly, there is no need for HUD to provide any exemption or safe harbor for payments made in the context of a Guaranteed Mortgage Package *if the payments are for services rendered*—which is the safe harbor that Congress provided for payments by title companies to attorneys—since such a safe harbor already exists in Section 8(c)(1)(B).

There are two basic reasons why we do not believe there is any discrepancy between the safe harbor provided for payments to attorneys for services rendered and ALTA’s position in opposition to the safe harbor that HUD is thinking of providing for payments and discounts within a Guaranteed Mortgage Package.

First, there is a fundamental difference between a safe harbor from the anti-kickback prohibitions *provided by Congress* and a safe harbor *provided by HUD* under a regulatory approach that does not have express Congressional authorization. At the Senate hearing, I submitted for the record a memorandum prepared by ALTA’s outside counsel that discusses HUD’s lack of statutory authority for its packaging proposal and we urge you or your staff to review that memorandum.

Second, the safe harbor HUD would provide has nothing to do with payments for services actually rendered, but is intended to permit the provision of kickbacks, referral fees, or discounts by providers of title, closing, and escrow services as a means of inducing a lender-packager to include the provider in the lender’s package. Such payments are squarely at odds with the Section 8 prohibitions *Congress adopted,* and are only being offered by HUD as carrots to encourage lenders to engage in packaging.

Accordingly, in response to your last question, we believe that our position opposing HUD’s granting of an exemption (safe harbor) from the kickback prohibition of Section 8 to parties involved in HUD’s proposed mortgage packaging has no relationship to, and is not inconsistent with, ALTA’s continued support for the safe harbor Congress provided in Section 8(c)(1) for payments to attorneys who actually render services.

"Did you personally select the title insurance company providing your owner's title coverage?"

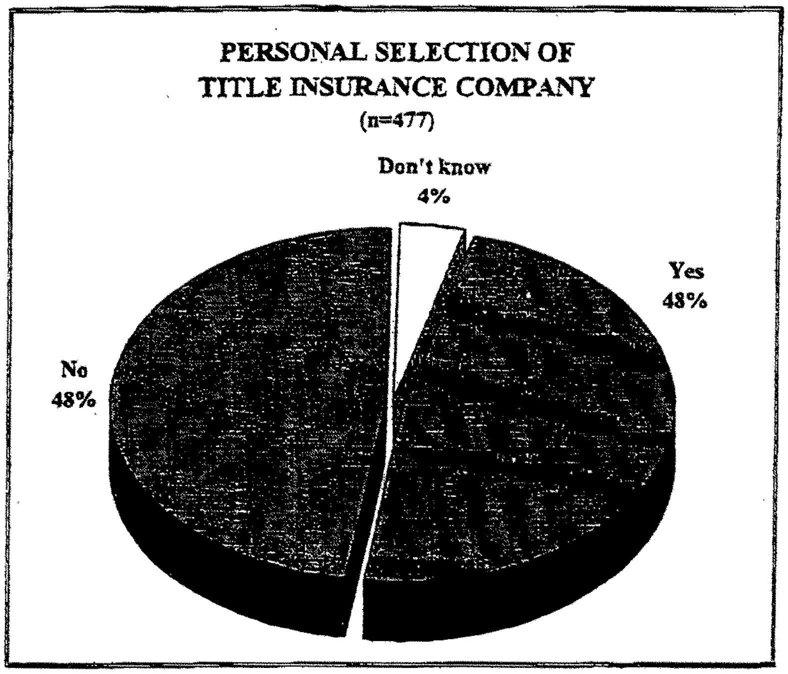

Figure 4

- Half (48%) of the respondents said they personally selected the title insurance company which provided their owner's title coverage while exactly the same percentage (48%) of respondents indicated they did not do so.

NEWS RELEASE

May 8, 2003

HUD ANNOUNCES SETTLEMENT IN CASE AGAINST 13 NEW YORK LAWYERS FOR VIOLATING REAL ESTATE SETTLEMENT PROCEDURES ACT

Federal Coordination Signals Stepped Up RESPA Enforcement

WASHINGTON—The Department of Housing and Urban Development today announced a settlement in a civil complaint brought against 13 attorneys in New York for violating the Real Estate Settlement Procedures Act (RESPA). In a case filed in Federal Court in the Eastern District of New York, the United States alleged the lawyers improperly referred their clients to title companies they formed, earning payments based solely on the volume of business referred.

As principle shareholders, the attorneys received referral fees from the title company that they established. As part of the agreement, the title company was required to file amended tax returns for the past 3 years.

First passed in 1974, RESPA prohibits certain practices that may artificially increase the cost of settlement services for consumers, thereby inflating the cost of buying or refinancing a home. For example, Section 8 of RESPA prohibits a person from giving or accepting any thing of value for referrals of settlement service business related to a Federally related mortgage loan. It also prohibits a person from giving or accepting any part of a charge for services that are not performed.

"We hope today's action will send a clear message to those who provide settlement services to consumers—basing your compensation exclusively on the volume of business referred violates RESPA," said John C. Weicher, HUD Assistant Secretary for Housing. "This case is an example of the excellent cooperation among HUD, the U.S. Attorney's Office and the Internal Revenue Service in enforcing Federal law and protecting the rights of consumers."

Brian Bass, S. Charles Buschemi, Michael M. Capasso, Thomas A. Capasso, Ronald Davies, Ronald Farr, Michael Grundfast, Irwin Izen, William J. Porter, Eric Sackstein, Barry Segal, Gary Smith, and Alan Wolinsky established Covenant Abstract Company, Inc. and two affiliated title companies—Citation Abstract Company and Titlewaves Abstract. The attorneys agreed to pay $200,000 for the settlement of the RESPA allegations and to divest themselves of any interest in a title company for 3 years.

Based on HUD's *Homebuyer Bill of Rights,* Secretary Mel Martinez last year proposed a sweeping reform of RESPA's regulatory requirements in an effort to greatly simplify and clarify the homebuying process for consumers. Get more information about this regulatory reform.

HUD is the Nation's housing agency committed to increasing homeownership, particularly among minorities, creating affordable housing opportunities for low-income Americans, supporting the homeless, elderly, people with disabilities, and people living with AIDS. The Department also promotes economic and community development, as well as enforces the Nation's fair housing laws. More information about HUD and its programs is available on the Internet.

STEPTOE & JOHNSON LLP

ATTORNEYS AT LAW

1330 Connecticut Avenue, NW
Washington, D.C. 20036-1795

Telephone 202.429.3000
Facsimile 202.429.3902
http://www.steptoe.com

Sheldon E. Hochberg
202.429.6218
shochber@steptoe.com

MEMORANDUM

January 22, 2003

TO: James R. Maher

FROM: Sheldon E. Hochberg
Alice E. Loughran

RE: Initial Analysis of Possible Challenge to HUD's Adoption of Final RESPA Regulations Along the Lines Proposed in July 2002.

INTRODUCTION

This memorandum provides an initial assessment of the major issues that you have asked us to consider in connection with a possible court challenge to final RESPA regulations that might be promulgated by the Department of Housing and Urban Development ("HUD") along the lines of the regulations HUD proposed in July 2002.[1] As discussed in more detail in the balance of this memorandum, our initial review of the relevant case law indicates the following.

- In a number of significant regards, the proposed regulations exceed HUD's current statutory authority under RESPA. In particular:

[1] Department of Housing & Urban Development, Simplifying and Improving the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers, 67 Fed. Reg. 49,134 (July 29, 2002) ("HUD Proposed Regs.").

  - HUD's proposed revised "good faith estimate" ("GFE") regime imposes obligations and sanctions on lenders that are in conflict with the GFE regime established by Congress in § 5 of RESPA and, in fact, would establish a regime that is similar to the disclosure regime Congress repealed in 1975; and

  - HUD's GMPA regime likewise conflicts with § 5 and lacks any statutory basis. HUD cannot avoid this conflict and lack of authority by claiming that it is not mandating anyone to provide GMPAs but is merely using its inherent authority to exempt transactions from RESPA § 8, and its general authority to issue regulations under § 19, so as to encourage lenders and others to offer GMPAs.

- Trade associations whose members were adversely affected by the final regulations, including associations representing lenders who would be directly affected by the revised GFE and GMPA regulations, and associations representing settlement service providers who would be adversely affected (even though not directly subject to the GFE and GMPA obligations) would have standing to bring such a challenge.

- There is a reasonable prospect of obtaining a preliminary injunction against implementation of the final regulations pending resolution of the underlying challenge to the agency's authority.

We would note that this is an initial assessment and that the final regulations adopted by HUD could be significantly different from the proposed regulations, perhaps in ways that would affect our analysis.

DISCUSSION

I. MAJOR ASPECTS OF HUD'S PROPOSED REGULATIONS THAT MIGHT BE CHALLENGED.

The following aspects of the proposed regulations, if carried through to any final regulations, would likely be the focus of a challenge. The discussion does not address the aspects of the proposals that relate to mortgage brokers that might be challenged by the mortgage brokerage industry.

A. HUD's Revised GFE Regime Is Inconsistent With RESPA And Congressional Intent In Certain Essential Regards.

First, the proposed GFE regime imposes obligations on lenders that go far beyond those Congress imposed in § 5(c) of RESPA. RESPA § 5(c) provides that, within three days of receiving an application, lenders must give consumers a "good faith estimate of the amount or range of charges for specific settlement services the borrower is likely to incur." In contrast, HUD's proposed GFE regime:

- would require lenders to guarantee the maximum charges that the borrower will pay, rather than providing an estimate of charges the borrower is likely to incur;[2] and
- would not require lenders to provide estimates of the charges for "specific settlement services" to be incurred by the borrower, but would only require disclosure of the aggregate costs for certain categories of charges.

Second, HUD's GFE proposal would provide unauthorized remedies against lenders who fail to comply with the new requirements. Under the HUD proposed regulations, a borrower who is charged more for any category of charges than is permitted under the GFE provided by the lender may walk away from the transaction and receive back all fees paid. Section 5 of RESPA provides no remedies for violations of a lender's GFE obligations and there is no basis in the statute for HUD to create such a remedy.

Third, as a result of these two aspects of the proposed regulations, a court is likely to conclude that HUD's revised GFE regime really regulates the amounts that may be charged by lenders and third-party service providers at closing, rather than regulating the "good faith estimates" that lenders must provide. This can be appreciated by considering the following question: what behavior triggers the applicant's right to walk away from the transaction and

[2] The fact that, with regard to certain categories of charges, the actual charges may exceed the estimate by up to 10% would not change the fact that under HUD's proposed rules a lender must guarantee the total amount of those categories.

receive back any fees paid? The answer is: if the charges imposed at settlement exceed the estimates provided in the revised GFE. In other words, lender liability is not based on whether the lender's estimates were made in good faith at the time they were made. Rather, it is based on whether the charges at closing exceed the estimates (as increased by any tolerances). Thus, contrary to the obligation imposed on lenders by Congress – which does not hold the lender responsible if final settlement costs exceed the lender's good faith estimate – HUD's proposed GFE regime would impose sanctions on lenders for failing to ensure that settlement charges do not exceed their estimates.

Fourth, the legislative history of the good faith estimate requirement in § 5(c) – which was accompanied by Congress's repeal of the original § 6 of RESPA that provided for advance disclosures of the actual charges to be incurred – supports the view that HUD's proposed GFE regime is in conflict with congressional intent.

The original RESPA statute included a separate section 6 entitled "Advance Disclosure of Settlement Costs" which required lenders, at the time of the loan commitment, but not later than 12 days prior to settlement, to provide to the prospective buyer and seller an "itemized disclosure in writing of each charge arising in connection with the settlement."[3] The section imposed a duty on the lender to obtain from persons who were to provide services in connection with the settlement "the amount of each charge they intend to make." If the exact charge was not available, a good faith estimate could be provided. Section 6(b) provided for lender liability to the buyer and/or seller for failing to provide the requisite disclosures in the amount of actual damages or $500, whichever was greater, plus, if the action was successful, court costs and attorney's fees.

[3] Sec. 6 of the Real Estate Settlement Procedures Act, Pub. Law 93-533 (Dec. 22, 1974).

Concerns about this provision were raised by lenders, with the result that, within one year of enactment, Congress repealed section 6 and substituted for it the language of § 5(c) requiring lenders to provide a good faith estimate of settlement costs (along with the HUD Special Information Booklet) within three days of a loan application.[4] Pointedly, and unlike the repealed § 6, Congress decided not to impose any sanctions or remedies for violations of this § 5(c) obligation.

In short, the kind of disclosure regime HUD is now proposing – requiring firm information on the actual charges for settlement services, backed by sanctions against lenders who fail to provide such disclosures – was, at one time, authorized by Congress in RESPA, but that authorization was repealed in 1975.

B. The Proposed GMPA Regime Uses HUD's Exemption Authority In An Unauthorized Way To Create A Regime That Is Inconsistent With RESPA.

An analysis of the inconsistencies between HUD's proposed Guaranteed Mortgage Package Agreement (GMPA) regime and RESPA is a bit more complicated because HUD is not requiring any lender (or other party) to offer GMPAs or to take any action that is inconsistent with RESPA, but is simply setting out the conditions under which an exemption from § 8 will be provided to those person who elect to package and participate in packages. Nevertheless, we do not believe that HUD can avoid the need for appropriate statutory authorization for both the

---

[4] Pub. L. No. 94-205 (Jan. 2. 1976). The report of the House Committee on Banking, Housing and Urban Affairs described the problems created by § 6's requirement for lenders to determine and disclose the "exact amount" of each settlement charge under "rigid time constraints" and indicated that the amendment made by the committee to § 5(c) imposed a more general requirement "for the lender to include with the special information booklet a good faith estimate of the amount or range of charges for specific settlement services the prospective borrower is likely to incur in connection with the settlement." H.R. Rep. No. 94-667 at 4-5 (1975), *reproduced in* 1975 U.S.C.C.A.N. 2451-52.

revised GFE and the GMPA regimes by contending that lenders are not required to comply with either regime because they have an option to select the other regime.

Moreover, as will be discussed in Part II.B., below, there is precedent to support the conclusion that if the underlying behavior HUD is seeking to encourage – the provision of GMPAs in lieu of providing the kind of good faith estimates called for by § 5 – is inconsistent with, or unauthorized by, RESPA's provisions, HUD cannot use an exemption from § 8 as the authority for creating its "voluntary" GMPA regime. As the D.C. Circuit concluded in Brae Corp. v. United States, 740 F.2d 1023, 1055 (D.C. Cir. 1984), cert. denied, 471 U.S. 1069 (1985), an agency does not have "carte blanche to rewrite the . . . Act under the umbrella of its exemption powers."

With regard to HUD's proposed GMPA regime, litigation against HUD would likely focus on the following ways in which HUD's action is inconsistent with RESPA.

First, HUD's use of its exemption authority under RESPA §§ 8(c)(5) and 19 is inconsistent with the authority Congress intended to grant HUD in those sections. As discussed in the April 8, 2002 White Paper to HUD submitted as an attachment to ALTA's October 4, 2002 comments to HUD, while § 8(c)(5) gives the Secretary authority to clarify when questionable payments are really not the kind that Congress intended to proscribe, that provision does not give the Secretary blanket authority to rewrite § 8 by carving out exemptions for behavior that would otherwise violate § 8. Furthermore, § 19(a) of RESPA, as added by the 1975 amendments, authorizes the Secretary to "grant such reasonable exemptions for classes of transactions, as may be necessary to achieve the purposes of [RESPA]." To the extent that the HUD GMPA regime would exempt lenders who offer GMPAs from having to identify, and provide estimates for the costs of, the individual settlement services in the package, or would

exempt packagers from the affiliated business referral requirements (that prohibit a lender from requiring the use of an affiliated provider), such an exemption would likely be viewed by the courts as neither "reasonable" nor "necessary" to achieve RESPA's purposes.

Second, apart from whether § 8(c)(5) authorizes the kind of exemptions HUD will provide to packagers, the behavior HUD wants to encourage is inconsistent with the obligations imposed on lenders by RESPA in many of the ways discussed above with regard to the GFE regime:

- the GMPA regime imposes obligations on lenders that go far beyond those Congress imposed in § 5(c) of RESPA; and
- the GMPA regime really regulates the amounts that may be charged by lenders and third-party service providers at closing, rather than regulating the "good faith estimates" that lenders must provide.

Third, the GMPA regime would impose obligations on lenders that conflict with a lender's rights or obligations under other federal statutes. For example, requiring a lender to guarantee the interest rate on a loan even though the borrower has not locked in the loan rate, or prohibiting a lender from charging more, or recouping higher charges by third parties than it initially guaranteed, raise safety and soundness issues and potential conflicts with the rights and powers of federally-regulated depository institutions under their organic statutes. Similarly, many of the GMPA requirements are inconsistent with the obligations of mortgage lenders under the Truth in Lending Act.

II. THERE IS AMPLE AUTHORITY TO SUPPORT A SUCCESSFUL CHALLENGE TO THE HUD REGULATIONS.

HUD's assertion of authority to promulgate the revised GFE and GMPA regulations appears to be fundamentally misconceived. HUD starts from the premise that it has the inherent authority to promulgate rules and regulations that it believes best serve the consumer's interest, ignores the operative provisions of RESPA that speak directly to Congress's intent on lender disclosures of estimated settlement costs, and basically relies on its general rulemaking and exemption powers for the legal authority for its rules.

The courts will approach the issue from precisely the opposite direction. The courts will begin the inquiry by focusing on the specific provisions that speak to Congress' intent and, if Congress' intent on the subject is clear, that is the end of the matter. Given the clarity of the directly relevant statutory language and other evidence of congressional intent, we believe the courts will conclude that Congress has specified a particular approach to lender estimates of settlement costs that is inconsistent with the regulatory regimes HUD is attempting to establish. Indeed, in three relatively recent appellate court decisions, the courts have adopted precisely this approach in rejecting HUD's interpretation that RESPA § 8(b) prohibits mark-ups of third-party charges.[5] These RESPA-related decisions will be powerful precedents in any case where HUD's regulations are challenged as being inconsistent with statutory language or intent. Indeed, a court might find it shocking that, in the face of three recent circuit court decisions that have made clear that HUD may not impose obligations on lenders and settlement service providers that

[5] Haug v. Bank of America, N.A., No. 02-2458 (8th Cir. Jan. 23, 2003); Krzalic v. Republic Title Co., 2002 WL 31873609 (7th Cir. Dec. 26, 2002); Boulware v. Crossland Mtge. Co., 291 F.3d 261 (4th Cir. 2002).

exceed those specified by Congress in RESPA, HUD would adopt regulations that have precisely that effect.

The fact that HUD may have general rulemaking authority, or authority to establish exemptions from § 8, cannot, we believe, overcome the fact that HUD's regulations compel or encourage behavior that is inconsistent with the regulatory approach adopted by Congress. As the U.S. District Court for the District of Columbia noted in a recent decision overturning a regulation of the Food and Drug Administration:

> This court does not pass judgment on the merits of the FDA's regulatory scheme. The [] Rule may well be a better policy tool than the one enacted by Congress . . . The issue here is not the Rule's wisdom. . . . The issue is the Rule's statutory authority, and it is this that the court finds lacking.[6]

A. HUD's Proposed GFE Is Inconsistent With The Disclosure Regime Congress Enacted.

HUD cites as legal authority for its proposed regulations its inherent rulemaking powers under RESPA § 19 and its exemption authority under § 8(c)(5), but does not specifically cite the substantive provision of RESPA – § 5(c) – that addresses a lender's obligations to provide applicants with estimates of closing costs.[7] There is good reason for the omission. The text of § 5 could not be clearer with regard to the regime Congress intended to have applied and the HUD-proposed GFE regime is radically different.

---

[6] Association of American Physicians and Surgeons, Inc. v. U.S. Food and Drug Admin., 226 F.Supp.2d 204 (D.D.C. Oct. 17, 2002). Indeed, the court also noted that a general grant of rulemaking power "must effectuate a congressional objective expressed elsewhere in the Act." Id. at 213.

[7] HUD Proposed Rule, 67 Fed. Reg. at 49,137-38 ("**II. General Background.** *A. Legal Authority.* The Department is proposing this rule in accordance with 5 U.S.C. 552, Sections 19 and 8(c)(5) of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2617).")

Section 5, which is entitled "Estimate of charges," states in precise terms that lenders shall provide a "good faith estimate" of the amount or range of charges for "specific settlement services" the borrower "is likely to incur . . . ." The courts will interpret those words as taking their ordinary, common sense, and natural meaning. Sullivan v. Everhart, 494 U.S. 83, 103 (1990). "Estimate" in its ordinary meaning is a "rough or approximate calculation only." Black's Law Dictionary 382 (Abridged 6th ed. 1991). This plain reading is reinforced by the language that this estimate must be made in "good faith." The plain language is also clear that the estimates are to reflect the charges for "specific settlement services" the consumer is "likely to incur." In contrast, HUD's revised GFE regime would require lenders to provide binding figures for the maximum charges the consumer will pay for certain groups of charges, with no information on the charges for specific settlement services.

Because § 5 is clear as to congressional intent, a court should not grant deference to HUD for its proposed GFE and GMPA approaches under the principles for judicial review of agency interpretations established in the landmark decision of Chevron U.S.A. Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984). The Chevron rule is intended to honor a presumed congressional intention to delegate to a federal agency the policy-making authority to interpret an ambiguous statute. Thus, under Chevron, when the language in a statute has a range of meanings, the agency (within limits) rather than the courts is entitled to choose which reasonable meaning best effectuates the objectives of the statute. But when Congress itself has made its intent clear – as it has done in the plain text of § 5 – its specific intention necessarily overrides any discretion the agency might have to apply its own view of what is the best way to achieve

the purposes of the statute. There is abundant Supreme Court precedent on this point.[8] In this case, HUD's proposed regulation is not an interpretation of § 5, but a rewrite of § 5.

Moreover, Congress had adopted – and then, quickly, repealed – a disclosure regime that is similar to the one HUD now seeks to put in place. As discussed above, RESPA as originally enacted contained a provision that required lenders to disclose the actual settlement charges at the time of the loan commitment, and penalized lenders who failed to fulfill that obligation, but this provision was repealed in 1975 and replaced with the current language of §5(c). While the repealed disclosure provision was not precisely the same as HUD's proposed GFE regime, there are certain key similarities. As a consequence, the courts are likely to look at the repeal of that disclosure provision and the concomitant enactment of § 5(c) as evidence of congressional intent regarding the kind of disclosure/estimate regime Congress wanted to have applied to lenders. See Chevron, 467 U.S. at 843 n.9 (court employs all "traditional tools of statutory construction" in determining Congress' intent).

The courts have reversed agencies on such evidence of congressional intent. For example, the courts have invalidated agency interpretations that were previously considered and

[8] See, e.g., Whitman v. American Trucking Ass'ns, 531 U.S. 457, 481 (2001) (vacating EPA's regulation because it "contradicts what in our view is quite clear" in the statutory text); NCUA v. First Nat'l Bank & Trust Co., 522 U.S. 479, 501 (1998) (rejecting agency's reading of the statute because "that is simply not what the statute provides"); Brown v. Gardner, 513 U.S. 115, 122 (1994) (fact that Department of Veterans Affairs regulation "flies against the plain language of the statutory text exempts courts from any obligation to defer to it."); Dole v. United Steelworkers of America, 494 U.S. 26, 42-43 (1990) ("Because we find that the statute, as a whole, clearly expresses Congress' intention, we decline to defer to OMB's interpretation"); Maislin Indus. v. Primary Steel, Inc., 497 U.S. 116, 131 (1990) (declining to defer to agency interpretation that was "flatly inconsistent with the statutory scheme as a whole"); Public Employees Retirement System v. Betts, 492 U.S. 158, 171 (1989) (refusing to accord deference to ADEA interpretive regulation, because "of course, no deference is due to agency interpretations at odds with the plain language of the statute itself").

rejected by Congress in the bill drafting process.[9]

In the commentary accompanying its proposed regulations, HUD attempts to support the proposed regimes by emphasizing policy arguments in support of its approaches, such as the need to "simplify and improve the process of obtaining home mortgages and reduce settlement costs for consumers," and the fact that changes have taken place in the marketplace which "if properly addressed by the Government, could result in greater price reductions for consumers."[10] Those policy objectives are irrelevant to whether HUD has statutory authority for its revised GFE and GMPA approaches. Agencies do not have *carte blanche* authority to regulate in a manner that is not based on, and consistent with, the regulatory regime established by Congress.[11] As the Supreme Court has cogently made clear, "[a]gencies may play the sorcerer's apprentice but not the sorcerer himself." Alexander v. Sandoval, 532 U.S. 275, 291 (2001).

---

[9] Brown & Williamson Tobacco Co. v. FDA, 529 U.S. 120, 144, 146-48 (2000) ("Congress considered and rejected bills that would have granted the FDA such jurisdiction"); INS v. Cardoza-Fonseca, 480 U.S. 421, 442-43 (1987) ("The enactment of the House bill rather than the Senate bill . . . demonstrates that Congress eventually refused to" adopt the interpretation now urged by the agency); Commonwealth of Pennsylvania v. Dep't of HHS, 928 F.2d 1378, 1386 (3d Cir. 1991) ("Because the Conference had before it [similar language] . . . and did include it, . . . we believe HHS may not reinsert the omitted language by regulation").

[10] HUD Proposed Regs., 67 Fed. Reg. at 49,134.

[11] See, e.g., Brown & Williamson Tobacco Co. v. FDA, 529 U.S. at 159 ("no matter how 'important, conspicuous, and controversial' the issue, an administrative agency's power to regulate in the public interest must always be grounded in a valid grant of authority from Congress"); MCI Telecomm. v. American Tel. & Tel. Co., 512 U.S. 218, 234 (1994) ("the Commission's estimations . . . of desirable policy cannot alter the meaning of the federal Communications Act of 1934"); Central Bank v. First Interstate Bank, 511 U.S. 164, 188 (1994) ("Policy considerations cannot override . . . the text and structure of the Act"); Mertens v. Hewitt Associates, 508 U.S. 248, 261 (1993) ("vague notions of a statute's 'basic purpose' are . . . inadequate to overcome the words of its text regarding the specific issue under consideration"); LeFlore v. Marvel Entertainment Group, 493 U.S. 120, 126 (1989) ("Our task is to apply the text, not to improve upon it"); Bureau of Alcohol, Tobacco and Firearms v. Federal Labor Relations Authority, 464 U.S. 89, 97 (1983) ("The deference owed to an expert tribunal cannot be allowed to slip into a judicial inertia which results in the unauthorized assumption by an agency of major policy decisions properly made by Congress"); Engine Mfrs. Ass'n v. EPA, 88

HUD suggests that the new GFE regime is authorized under its general grant of rulemaking power in § 19 (which authorizes the Secretary to "issue such rules and regulations, . . . and grant such reasonable exemptions for classes of transactions . . . as may be necessary to achieve the purposes of this chapter"). Under established administrative law principles, however, HUD cannot use its general rulemaking power to alter or set aside the detailed regime set forth in a separate statutory provision that "directly address[es]" the particular subject in issue and "reflect[s] a specific set of congressional concerns." Brae Corporation, 740 F.2d 1023, 1059 (D.C. Cir. 1984). The recent decision in Association of American Physicians and Surgeons, Inc. v. U.S. Food and Drug Admin., 226 F. Supp. 2d 204 (D.D.C. 2002), striking down the FDA's "Pediatric Rule" (providing for testing by drug manufacturers on potential pediatric patients for whom the drug might be prescribed) reinforces the fact that regulations issued under an agency's general rulemaking authority "must effectuate a congressional objective expressed elsewhere in the Act" and "does not constitute an independent grant of authority" that permits the agency to "issue any regulation the agency determines would advance the [general purposes of the Act]." Id. at 213.

In sum, Congress in § 5 adopted specific and limited requirements regarding a lender's obligations to provide estimates of closing costs to applicants. We believe that the courts will conclude that HUD's proposed GFE regime has not respected those requirements and limitations, and that HUD lacks authority to promulgate its revised GFE regime as currently proposed.

F.3d 1075, 1089 (D.C. Cir. 1996) (agency may not disregard "the Congressional intent clearly expressed in the text simply by asserting that its preferred approach would be better policy").

B. There Are Good Arguments That HUD Lacks The Statutory Authority To Use Its Rulemaking and Exemption Authority Under RESPA §§ 8 And 19 To Create The GMPA Regime It Is Proposing.

As noted in Part I, above, HUD may contend that it can use its exemption powers under RESPA §§ 8(c)(5)[12] and 19 to encourage lenders (and others) to engage in packaging. Because federal agencies generally do not seek to create extensive regulatory regimes through the vehicle of conditional exemptions from other statutory requirements, there is relatively limited case law involving challenges to such actions. However, we believe that there are two separate (though related) bases on which this aspect of the proposed regulations may be successfully challenged.

1. HUD's authority to exempt payments and practices from § 8 does not extend to exempting payments and practices that would otherwise constitute violations of § 8.

As discussed in greater detail in the April 8, 2002 memorandum submitted to HUD and entitled "Why Legislative Authority is Needed to Implement a Regime of Lender Guaranties of Closing Costs," the scope of the Secretary's exemption power under § 8(c)(5) should be read in consonance with the preceding provisions of § 8(c) which make clear that nothing in § 8 "shall be construed as prohibiting" certain payments that Congress did not regard as violating § 8. As discussed in that memorandum, § 8(c)(5) does not authorize the Secretary to exempt payments that would otherwise clearly violate § 8 but which the Secretary is prepared to exonerate if they are made in the context of practices or transactions he would like to encourage (packaging). This is particularly the case where the substitute regulatory regime HUD would impose on those

[12] RESPA §8(c)(5), 12 U.S.C. § 2607(c)(5), provides that nothing in § 8 shall be construed as prohibiting "such other payments or classes of other payments or transfers as are specified in regulations prescribed by the Secretary after consultation with the Attorney General, the Administrator of Veterans' Affairs, the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Secretary of Agriculture."

seeking to take advantage of the § 8 exemption is not authorized or even contemplated by the statute itself.

RESPA as originally enacted did not provide explicit statutory authority for HUD to promulgate regulations and interpretations for all of its provisions. In particular, a significant issue that arose almost immediately after RESPA became law at the end of 1974 was whether payments among real estate brokers and agents pursuant to cooperative brokerage arrangements or referral arrangements – long-standing practices in the real estate brokerage industry – might be deemed to violate § 8(a). As a consequence of this and other uncertainties created by the original language of RESPA, legislation to amend the statute was introduced in 1975 and hearings were held by the House and Senate. At those hearing, the witness for the National Association of Realtors® discussed why such practices among real estate brokers and agents did not adversely affect consumers, explained that "[i]t is clear from the history of RESPA that neither of these practices were intended to be hit by the anti-kickback provision," and proposed an "explicit clarifying exemption" for these practices.[13]

The clarifying amendment suggested by the National Association of Realtors® was enacted as part of the Real Estate Settlement Procedures Act Amendments of 1975, Pub. L. No. 94-205 (Jan. 2, 1976). Specifically, section 8(c) was amended to add "payments pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and brokers" to the list of payments for services rendered that Congress had previously identified in 8(c) as not being the kind of payments prohibited by § 8. Indeed, the relevant committee report

---

[13] *The Real Estate Settlement Procedures Act of 1974: Hearings on H.R. 5352, S.2327, and H.R. 0283 Before the Subcommittee on Housing and Community Development of the House Committee on Banking, Currency and Housing*, 94th Cong., 1st Sess., 240, 253-57 (1975) (statement of Art S. Leitch, President, National Association of Realtors®).

explained the cooperative- brokerage amendment as "mak[ing] clear" that such payments "are not considered kickbacks."[14]

In addition to clarifying that cooperative brokerage arrangements were not the kind of payments intended to be prohibited by § 8, Congress further amended § 8(c) to provide that nothing in § 8 shall be construed as prohibiting:

> "such other payments or classes of other payments or transfers as are specified in regulations prescribed by the Secretary after consultation with the Attorney General, the Administrator of Veterans' Affairs, the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Secretary of Agriculture."[15]

Although the Committee report describes this provision as giving the Secretary authority to "exempt" other classes of transactions or payments from § 8, the language of the provision, its placement in § 8(c), and normal rules of statutory construction suggest that the Secretary's authority under this provis ion is not without limits and the exercise of that authority must be consistent with the common principle derived from the other subparagraphs that precede this grant of authority to the Secretary.[16]

---

[14] H.R. Rep. 94-667, at 7 (1975, 1975 U.S. Code Cong. & Admin. News 2448, 2454.

[15] 89 Stat. 1158. While this language was originally contained in § 8(c)(4), § 8(c) was further amended in 1983 to place this language in § 8(c)(5).

[16] In the 1975 RESPA amendments, Congress also added § 19(a) to the Act, providing the Secretary with the authority to "prescribe such rules and regulations, to make such interpretations, and to grant such reasonable exemptions for classes of transactions, as may be necessary to achieve the purposes of this Act." Because § 8(c)(5) specifically addresses the Secretary's authority to determine when payments are not subject to RESPA § 8, it controls over the more general authority in § 19(a). See, e.g., Morales v. Trans World Airlines, Inc., 504 U.S. 374, 385 (1992) ("it is a commonplace of statutory construction that the specific governs the general"); N.L.R.B. v. A-Plus Roofing, Inc., 39 F.3d 1410, 1415 (9th Cir. 1994) ("It is a well-settled canon of statutory construction that specific provis ions prevail over general provisions").

Moreover, even if HUD were to consider granting an exemption from § 8 under the authority of § 19(a), such exemption would have to be "reasonable." Granting an exemption for

The common principle that runs through the other subparagraphs that precede this language is that none of the payments or practices identified in those subparagraphs would otherwise constitute clear violations of § 8 in the absence of the clarification provided by § 8(c). This should not be surprising in light of the fact that, as the introductory language of § 8(c) indicates (i.e., nothing in § 8 "shall be construed as prohibiting" the payments and practices identified in the subparagraphs), Congress was not attempting in § 8(c) to exempt abusive practices from § 8 coverage. Rather, Congress was simply trying to make clear the kind of practices and payments that were never intended to be covered by § 8.

The fact that Congress authorized the Secretary in § 8(c)(5) to identify "such other payments or classes of payments or transfers" that would likewise not be "construed" as coming within the prohibitions of § 8 demonstrates that Congress contemplated that the Secretary's authority under this provision would be exercised in a manner consistent with the type of "clarifying" approach Congress had adopted in the previous paragraphs of subsection (c).

The principle of statutory construction known as *ejusdem generis* further supports the conclusion that the "such other payments" language in § 8(c)(4) should be construed in a manner consistent with the common attribute of the other types of payments that are discussed in the preceding subparagraphs. As described in a leading treatise:

> [I]n accordance with what is commonly known as the rule of *ejusdem generis*, where in a statute general words follow a designation of particular subjects or classes of persons, the meaning of the general words will ordinarily be presumed to be, and construed as, restricted by the particular designation, and as including only things or persons of the same kind, class, character, or nature as those specifically enumerated. In accordance with the

---

payments that would otherwise clearly violate § 8 in order to encourage a lender guarantee/packaging regime not authorized by Congress but believed to be desirable by HUD would not appear to constitute a "reasonable" exemption.

> rule of *ejusdem generis*, such terms as "other," . . . when preceded by a specific enumeration, are commonly given a restricted meaning, and limited to articles of the same nature as those previously described.[17]

In sum, it can be argued that, while § 8(c)(5) gives the Secretary authority to clarify when questionable payments are really not the kind that Congress intended to proscribe, that provision does not give the Secretary blanket authority to rewrite § 8 by carving out exemptions for behavior that would otherwise violate § 8. The use of such exemptions is particularly suspect where, as here, it is intended to help launch a new regulatory regime that has no legislative mandate or imprimatur.

2. An agency may not use its exemption power to establish a regulatory regime that is inconsistent with the regime established by Congress.

Even if a court were to conclude that the Secretary's exemption power under § 8(c)(5) is not limited in the manner discussed in subsection 1, above, case law indicates that HUD cannot use its exemption authority to encourage, and enforce compliance with, a GMPA regime that HUD could not establish directly. In essence, HUD cannot gain a power that Congress did not grant by invoking § 8(c)(5)'s exemption provision. Under HUD's logic, it could – unshackled by any restrictions in the statute – encourage the mortgage lending and settlement services industries to behave in any way it thought desirable by providing an exemption from § 8 for such behavior.

A relevant decision on this issue is Brae Corp. v. United States, 740 F.2d 1023 (D.C. Cir. 1984). In that case, the court examined new regulations adopted by the Interstate Commerce Commission regarding "car hire" charges paid by railroads transporting boxcars to other railroads that owned the boxcars. Under the Staggers Rail Act of 1980, the ICC was given

---

[17] 73 Am. Jur. 2d (Statutes) § 135.

authority to deregulate rail rates by exempting persons or transactions from certain regulatory provisions. The legislative history made clear that the ICC could provide a complete or partial exemption. The new car hire regulations adopted by the ICC left untouched the basic per diem rate structure that the ICC had previously adopted for boxcars pursuant to the relevant statutory standards under the Interstate Commerce Act, but established a new regime that gave a "partial exemption" from those per diem rate regulations to railroads that met certain conditions. The ICC believed that this approach of "partial exemption from regulation subject to conditions" would achieve certain desirable objectives in the efficient use of boxcars that its per diem rate regulations were not achieving. In essence, like HUD's approach to the GMPA regime, the ICC believed that its new regulatory approach was preferable to the existing regulatory approach and that it could implement this new regulatory approach under its statutory authority to grant full and partial exemptions.

The D.C. Circuit disagreed. While recognizing that the ICC could grant partial exemptions, it found that the Commission's power in this regard was limited to the power to deregulate: to remove regulatory burdens rather than to allow the ICC to impose "a new regulatory framework" over the car hire relationship under the guise of an exemption: "[A]ny other reading would give the Commission carte blanche to rewrite the Interstate Commerce Act under the umbrella of its exemption powers." Brae Corp., 740 F.2d at 1055. The court found that the Commission had "pursued a regulatory goal under the guise of deregulation. In other words, a decision to introduce certain measures into the marketplace to induce a particular desired response can hardly be characterized as deregulation." Id. at 1057. In response to the Commission's argument that it was making a reasonable policy decision in its use of its exemption power to encourage more efficient behavior, the court stated:

> That the car hire decision may represent a policy choice, however, only bolsters our conclusion that the Commission here in fact was not deregulating. Deciding which party should bear the cost of moving empty boxcars, regardless of market factors, is not the stuff of deregulation; section 10505(a) [authorizing Commission exemptions] was not enacted as a means for the Commission to impose new regulatory policies on the railroad industries.[18]

Other attempts by federal agencies to rewrite their statutory regimes by granting exemptions that are at odds with other statutory provisions have run into significant difficulties with the courts, which have held that an agency may not create exemptions from statutory requirements that the statute does not authorize.[19]

Accordingly, the Supreme Court has invalidated agency rules that conjure up powers for the agency beyond those authorized by Congress. See, e.g., Ragsdale v. Wolverine World Wide, Inc., 535 U.S. 81, 122 S. Ct. 1155, 1162 (2002) (Secretary of Labor's regulation was a "regulatory sleight of hand" which "alters" the Act "in a fundamental way"); MCI Telecomm. v. American Tel. & Tel. Co., 512 U.S. 218, 231 (1994) (FCC's exemption from rate filings procedures constituted a "fundamental change" to the "heart" of the underlying statute).[20]

---

[18] Id.

[19] Lee v. Gallup Auto Sales, Inc., 135 F.3d 1359, 1361-62 (10th Cir. 1998) (regulation that exempted certain vehicles from statutory disclosure requirements on odometers invalid); Diersen v. Chicago Car Exch, 110 F.3d 481, 485-86 (7th Cir. 1997) (same), cert. denied, 522 U.S. 868 (1997); Orca Bay Seafoods v. Northwest Truck Sales, Inc., 32 F.3d 433, 434-36 (9th Cir. 1994) (holding that a different exemption under the same regulation was invalid).

[20] See also Arent v. Shalala, 70 F.3d 610, 620 (D.C. Cir. 1995) (Wald, J., concurring) (noting that the court may invalidate agency decision as inconsistent with its statutory mandate, even though decision was not arbitrary, where it "believe[s] the agency's course of action to be the most appropriate and effective means of achieving a goal, but determine[s] that Congress has selected a different – albeit, in [the court's] eyes, less propitious – path."); Beverly Enterprises, Inc. v. Herman, 119 F. Supp. 2d 1, 11 (D.D.C. 2000) ("it is not the province of this Court to authorize substitution of a potentially more effective method where Congress has clearly provide for one in the statute").

The presumption is that Congress did not intend to give HUD such broad authority to revise how mortgage loans and settlement services are provided and priced. "An implied delegation of a law-declaring function is especially likely where . . . the question is interstitial, involves the everyday administration of the statute, implicates no special judicial expertise, and is unlikely to affect broad areas of the law." St. Luke's Hosp. v. Secretary of Health & Human Servs., 810 F.2d 325, 331 (1st Cir. 1987) (Breyer, J.). Conversely, the larger the question at stake, and the more significant its impact, the less likely it is that Congress intended to authorize the agency to decide it. See BATF v. FLRA, 464 U.S. 89, 97 (1983) (no deference to agency's "unauthorized assumption . . . of major policy decisions properly made by Congress"); United States v. Haggar Apparel Co., 526 U.S. 380, 392 (1999) (Congress makes "general policy," agency implements it). Here, there is no reason to believe that Congress intended to give HUD the sweeping power to restructure the way in which mortgage loans and settlement services are provided and paid for under the guise of allowing it to exempt certain payments or practices from RESPA § 8.

III. TRADE ASSOCIATIONS WHOSE MEMBERS ARE ADVERSELY AFFECTED BY THE REGULATIONS WOULD HAVE STANDING TO BRING A CHALLENGE.

A. Associations Whose Members Are Adversely Affected By The HUD Regulations Would Have Standing To Challenge The HUD Regulations.

"It has long been settled that even in the absence of injury to itself, an association may have standing solely as the representative of its members." UAW v. Brock, 477 U.S. 274, 281 (1986) (internal quotations, brackets and citation omitted). The three basic requirements for associational standing, laid out in Hunt v. Washington State Apple Advertising Commission, 432 U.S. 333, 343 (1977), are:

> (a) [the association's] members would otherwise have standing to sue in their own right; (b) the interests it seeks to protect are germane to the organization's purpose; and (c) neither the claim asserted nor the relief requested requires the participation of individual members in the lawsuit.

1. Associations representing lenders and settlement service providers would clearly meet the second and third Hunt requirements.

The second and third requirements of Hunt are easily satisfied here.

With respect to the second requirement, the "germaneness" inquiry is "undemanding"; "mere pertinence between litigation subject and organizational purpose" is sufficient." Humane Soc'y v. Hodel, 840 F.2d 45, 58 (D.C. Cir. 1988).[21] The interests that associations representing lenders and other settlement service providers seek to protect in challenging the HUD regulations are clearly germane to their organizational goals of ensuring a favorable regulatory environment and economic health for their members.[22]

With respect to the third requirement, the courts have required individual participation in circumstances when a specific factual setting is needed to illuminate the issues, or when necessary for damage determinations. Center for Auto Safety v. Nat'l Highway Traffic Safety Admin., 793 F.2d 1322, 1329 n.44 (D.C. Cir. 1986). A challenge to the HUD regulations would not require "individualized proof" from a plaintiff association's members because what it is being challenged is HUD's authority to promulgate the regulations and, therefore, is an issue that

---

[21] See also Competitive Enterprise Institute v National Highway Traffic Safety Administration, 901 F.2d 107, 111-12 (D.C. Cir 1990) ("mere pertinence"); American Insurance Association v. Selby, 624 F Supp 267, 271 (D.D.C. 1985) ("An association's litigation interests must be truly unrelated to its organizational objectives before a court will declare that those interests are not germane.").

[22] ALTA would have standing even if certain members favored HUD's regulation. See National Maritime Union v. Commander, Military Sealift Command, 824 F.2d 1228, 1234 (D.C. Cir. 1987) ("mere fact of conflicting interests among members of an association does not of itself defeat the association's standing to urge the interests of some members in litigation, even though success may harm the legal interests of some members").

could be "properly resolved in a group context." Hunt, 432 U.S. at 344; see also Committee for Effective Cellular Rules v. FCC, 53 F.3d at 1315 (an organization's broad facial challenge to agency's regulations does not require participation of individual members).

Accordingly, the second and third requirements of Hunt should easily be satisfied.

2. The first Hunt requirement would be satisfied as well.

To satisfy this requirement, an association must demonstrate that at least one of its members has a personal stake in the outcome of this controversy – that is to say a member would suffer some actual or threatened injury as a result of HUD's regulation. See Hunt, 432 U.S. at 343; see also Warth v. Seldin, 422 U.S. 490, 511 (1975). It is clear that associations representing mortgage lenders would easily satisfy this requirement, because the amended regulations would impose direct obligations on them that are inconsistent with the statute. We also believe that associations representing other settlement service providers who are adversely affected by the regulations would also be able to satisfy the "injury in fact" requirement.

First, the fact that the revised regulations do not direct or require such settlement service providers to engage in any particular behavior does not mean they would not be "injured" by the revised GFE and GMPA regulations. "[M]ere indirectness of causation is no barrier to standing, and thus, an injury worked on one party by another through a third party intermediary may suffice." National Wildlife Fed'n v. Hodel, 839 F.2d 694, 705 (D.C. Cir. 1988).[23] "[C]ollateral

[23] See also Telephone and Data Systems Inc. v. FCC, 19 F.3d 42, 47 (D.C. Cir. 1994) ("we need not attempt any broad explanation of the justiciability of indirect injury, for one narrow proposition is clear: injurious private conduct is fairly traceable to the administrative action contested in the suit if that action authorized the conduct or established its legality"); Public Citizen v. FTC, 869 F.2d 1541, 1547 & n.9 (D.C. Cir. 1989) (discussing third party injury cases).

consequences" of challenged action satisfy causation requirements for standing so long as their occurrence is not unduly speculative. Spencer v. Kemna, 118 S. Ct. 978, 985 (1998).

The Supreme Court has repeatedly held that a party has constitutional standing to complain of genuine injury to himself resulting from governmental regulation of someone else. For example, in Barlow v. Collins, 397 U.S. 159 (1970), tenant farmers were allowed to challenge an amendment to Department of Agriculture regulations allowing assignment of certain farm subsidy payments to pay rent for the land. The plaintiffs claimed the regulation injured them indirectly because it afforded landowners increased bargaining leverage, allowing the owners to insist on the assignment, depriving the tenants of cash and increasing their dependence on the owners. See id. at 160-63; see also Bennett v. Spear, 117 S. Ct. 1154 (1997) (water users had standing to complain of regulatory action affecting other demands for water).

The Supreme Court has likewise held that an indirect causal chain supported standing in Bryant v. Yellen, 447 U.S. 352, 366-68 (1980). There, would-be farm purchasers were found to have standing to seek declaratory relief challenging the Government's interpretation of reclamation laws that allegedly reduced the likelihood that third parties would make land available for purchase at below market prices. This indirect, and probabilistic, traceability was enough to meet the standing requirements "even though [the would-be purchasers] could not with certainty establish that they would he able to purchase excess lands" if declaratory relief were granted. Id. at 367.

Second, the argument that other settlement service providers may only suffer a loss in revenue or profitability because of the "voluntary" decisions by them to provide discounts or other things of value to lenders, would not adversely affect their standing. A party can satisfy

the injury requirement through the loss of a business opportunity.[24] Here, title companies and other settlement service providers would lose business opportunities with lenders and other customers if they do not agree to discounts. Moreover, they will be injured by not being able to compete directly for the consumer's business in the same way as they can under the current RESPA regime.[25]

Finally, the claims of "injury" to justify standing are not too speculative. The risk of future injury here is comparable to, or stronger than, that of other plaintiffs where the Supreme Court has found standing. While it is always possible that the ultimate injury-creating decisions would not be made, a plaintiff's burden is to show significant risk of injury, not certainty.

For example, in Bryant v. Yellen, 447 U.S. 352 (1980), the Supreme Court ruled that would-be purchasers of farmland could challenge the Secretary of Interior's suspension of reclamation laws barring delivery of federal irrigation water to any parcel of land larger than 160 acres held by a single owner. Plaintiffs argued that they were injured by the suspension because, if it were lifted, owners of larger parcels would sell their "excess" lands at "below market" prices

---

[24] See, e.g., Lepelletier v. FDIC, 164 F.3d 37 (D.C. Cir. 1999) ("This court . . . has held that the denial of a business opportunity satisfies the injury requirement."); Competitive Enterprise Institute v. National Highway Traffic Safety Admin., 901 F.2d 107, 112-13 (D.C. Cir. 1990) (consumer associations had standing to challenge fuel economy guidelines that would reduce the incentive for automobile manufacturers to produce large passenger cars, thus reducing consumers' opportunities to buy such cars); Public Citizen v. Foreman, 631 F.2d 969, 974, n.12 (D.C. Cir. 1980) (consumers had standing to challenge use of nitrites in bacon despite having choice of not eating bacon).

See also 13 Wright & Miller, Federal Practice & Procedure, § 3531.5 (2002) ("Standing is not defeated merely because the plaintiff has in some sense contributed to his own injury. Standing is defeated only if it is concluded that the injury is so completely due to the plaintiff's own fault as to break the causal chain.").

[25] Wedges/Ledges of California, Inc. v. City of Phoenix, Arizona, 24 F.3d 56, 61 (9th Cir. 1994) ("It is well settled that a provider of goods or services has standing to challenge government regulations that directly affect its customers and restrict its market.").

in order to qualify for irrigation deliveries. The Court acknowledged that the would-be purchasers "could not with certainty establish that they would be able to purchase excess lands if [the suspension were lifted]," id. at 367, but concluded that it was "highly improbable" that landowners would prefer to go without irrigation instead of selling enough lands to meet the 160 acre limit. Id. at 367-68.

In Pennell v. City of San Jose, 485 U.S. 1 (1988), landlords were held to have standing to challenge a provision in a rent control ordinance requiring reduced rents for tenants in financial distress. The appellees claimed the owners did not have standing because the prospect of injury was speculative, but the Supreme Court ruled that "[t]he likelihood of enforcement, with the concomitant probability that a landlord's rent will be reduced . . . is a sufficient threat of actual injury" to support standing. Id. at 8.[26]

Similar reasoning governs here. Speculation is not needed to divine the adverse consequences that will befall settlement service providers. Indeed, HUD's Impact Analysis makes clear that it expects settlement service providers to lose billions of dollars in revenue as a result of the implementation of its regulations.

---

[26] See also Village of Arlington Heights v. Metropolitan Hous. Dev. Corp., 429 U.S. 252, 261-62 (1977) (when challenged government action stands as a barrier to consummation of a detailed and specific project, court is not required to engage in undue speculation about likely success of project; business uncertainties attending every transaction should not operate to defeat standing); Secretary of State v. Joseph H. Munson Co., 467 U.S. 947, 954-55 (1984) (characterizing as an "actual injury" a charity's "reluct[ance] to enter into a contract" with a plaintiff fundraiser because of a challenged statutory limitation); Alliance for Clean Coal v. Miller, 44 F.3d 591, 594 (7th Cir. 1995) (out-of-state trade association had standing to challenge Illinois' coal act on ground that it impaired their ability to compete and did not have to show specific lost business opportunities); National Highway Traffic Safety Admin., 901 F.2d at 112-13 (lost opportunity to purchase vehicles of choice).

In short, we believe that associations representing mortgage lenders, title companies, and other settlement service providers who would be adversely affected by the revised regulations would have standing to challenge the regulations.

IV. THERE ARE REASONABLE PROSPECTS FOR OBTAINING A PRELIMINARY INJUNCTION AGAINST THE IMPLEMENTATION OF THE REGULATIONS PENDING RESOLUTION OF THE UNDERLYING CHALLENGE.

It is likely that HUD will have a delayed effective date for any final rule it publishes. During that period, there is a reasonable prospect of obtaining a preliminary injunction against the implementation of the regulation pending full judicial review (assuming the court will not be able to decide the merits of the underlying case in the delayed effective date period).

To obtain such equitable relief, the traditional Virginia Petroleum Jobbers criteria require that the moving parties demonstrate: (1) probability of success on the merits; (2) irreparable injury if a stay is denied; (3) no substantial harm to other parties if the stay is granted; and (4) no harm to the public interest if the stay is granted. Virginia Petroleum Jobbers Ass'n v. FPC, 259 F. 2d 921, 925 (D.C. Cir. 1958), see also Wash. Metro. Area Transit Comm'n v. Holiday Tours, Inc., 559 F.2d 841 (D.C. Cir. 1977). These four factors interrelate on a sliding scale and must be balanced against each other.[27]

For example, in Housing Study Group v. Kemp, 736 F. Supp. 321 (D.D.C. 1990), order clarified 739 F. Supp. 633 (D.D.C. 1990), the plaintiffs, a group of mortgage bankers with authority to act as coinsuring lenders under HUD's coinsurance program, filed suit to enjoin HUD from enforcing new rules that HUD promulgated to tighten its control over the operation of

[27] Serono Lab. v. Shalala, 158 F.3d 1313, 1317-18 (D.C. Cir. 1998). "If the arguments for one factor are particularly strong, an injunction may issue even if the arguments in other areas are rather weak." CityFed Fin. Corp. v. Office of Thrift Supervision, 58 F.3d 738, 746 (D.C. Cir. 1995).

the coinsurance program. The court granted a preliminary injunction enjoining HUD from enforcing the coinsuring lender letters. 736 F. Supp. at 336; see also World Duty Free Americas v. Summers, 94 F. Supp. 2d 61 (D.D.C. 2000) (enjoining temporary rules promulgated by ATF which would have barred customers from taking purchased tobacco to Canada); Building and Construction Trades Dep't, ALF-CIO, 543 F. Supp. 1282 (D.D.C. 1982) (enjoining regulations promulgated by Secretary of Labor).

All four factors appear to support a preliminary injunction here.

First, there is a substantial likelihood of success on the merits given the compelling evidence of congressional intent on the kind of disclosure/estimate regime Congress intended. See Building and Construction Trades Dep't, ALF-CIO, 543 F. Supp. at 1289-91 (substantial likelihood plaintiffs would show Secretary lacked authority to promulgate regulation given Act's legislative history).

Second, HUD's proposed changes to the existing regulatory regime are substantial and, the members of associations challenging the regulations will likely suffer irreparable harm unless the regulations are enjoined from becoming effective. While "mere economic loss, in and of itself, does not constitute irreparable harm," Housing Study Group v. Kemp, 736 F. Supp. at 330, the courts have held that a party suffers irreparable harm when it faces the loss of revenue or profits that cannot be recovered through subsequent corrective relief or legal remedies.[28]

With regard to the third and fourth criteria, it would appear that maintaining the *status quo* temporarily until the court acts on the merits of the litigation will not injure HUD and would

[28] See, e.g., Iowa Utils. Bd. v. FCC, 109 F.3d 418, 426 (8th Cir. 1996) and the cases cited therein ("The threat of unrecoverable economic loss . . . does qualify as irreparable harm."); Armour & Co. v. Freeman, 304 F.2d 404, 406 (D.C. Cir. 1962) (meat-packer established irreparable harm by showing Department of Agriculture regulation would "cause loss of profits which could never be recaptured"), cert. denied, 370 U.S. 920 (1962).

serve the public interest. See Building and Construction Trades Dep't, ALF-CIO, 543 F. Supp. at 1291 ("All concerned have lived under the old regulations and interpretations for well over forty years . . . . An additional period of delay while the legality of the regulations is judicially determined with finality cannot significantly harm either the government or others."). The public interest would clearly not be served if hundreds of thousands of businesses engaged in real estate financing and settlement services must take action to develop business arrangements, pricing, computer programs, etc. to comply with the final regulations only to have the regulations subsequently found to exceed HUD's statutory authority. Indeed, it is hard to see why HUD would oppose such a stay in light of the enormity of the potential disruption to an important segment of the American economy.

In sum, the balance of the four preliminary injunction factors would appear to weigh in favor of granting the preliminary injunction, particularly if lenders are co-plaintiffs.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED FROM CATHERINE B. WHATLEY

Q.1. In the prepared testimony of Russell K. Booth, for the July 9, 1997, Senate Banking Committee hearing on RESPA, TILA, and problems surrounding the mortgage origination process, NAR supported a reform to RESPA that would enable "one-stop-shopping," and quoted from a homebuyer survey from Hart-Riehle-Hartwig Research that indicated that, "Two in three (66 percent) [recent homebuyers] say that if they had to do it all over again, they would choose a real estate company that offers one-stop-shopping." Furthermore, the survey indicates that the changes to RESPA to create one-stop-shopping will result in greater convenience and less expense to consumers.

Most of the respondents endorse arguments in favor of the changes, saying there is a great deal of merit to the arguments that one-stop-shopping would be more convenient (53 percent), easier to manage with just one contact person (52 percent), and that some services might be cheaper when contracted through the real estate company (54 percent).

However, in your written testimony on the Proposed Rule, you do not support the idea of a Guaranteed Mortgage Package (GMP) which appears to me to be one-stop-shopping. What has happened in the interim to change your mind about this approach to mortgage retailing? Have consumers become less interested in one-stop-shopping? Have you surveyed consumers recently indicating such a change in sentiment? If so, can you please provide the survey to the Committee?

A.1. First, let me clarify our position regarding the HUD Guaranteed Mortgage Package (GMP) proposal. NAR believes the GMP is a radical departure from today's rules and HUD has not provided solid evidence of consumer and industry benefit. Specifically, the GMP proposal removes Section 8, the core consumer protection provision of RESPA. It would be premature for HUD to move forward with this proposal without fully assessing the consumer and the industry risk associated with these changes. NAR believes making changes to improve the Good Faith Estimate (GFE) is a far better way to improve the mortgage process for consumers. Incremental changes that will not disrupt the marketplace are a more sound approach to reform. As for the GMP, it would be far more prudent to issue a revised Proposed Rule that includes a new economic analysis and introduces alternative options to the GMP. This process would promote a more balanced policy objective and increase HUD's chances for industry and consumer support for a Final Rule at a later date.

Next allow me to clarify the events and circumstances that led to NAR's current position on RESPA reform. In June 1996 and in May 1997, HUD issued a couple of onerous amendments to RESPA that impacted the Affiliated Business Arrangement (AfBA) provisions. These actions were highly controversial at the time and many in the industry called for Congressional hearings, one of which is the referenced Senate Banking Committee hearing of July 9, 1997. During that time, NAR conducted a consumer survey to quantify the level of support among consumers for obtaining all of their homebuying services through one company or, one-stop-shop-

ping. NAR has always supported Affiliated Business Arrangements (AfBA's) as a means for offering one-stop-shopping. Many of our members currently offer these services and abide by the strict RESPA Rules that apply to these business relationships including full disclosure, the prohibition against referral fees and the prohibition against requiring the use of these services.

It wasn't until November 1997 that NAR considered and adopted a very narrowly defined concept of packaged settlement services. This was in response to a joint Congressional and industry effort to develop a consensus proposal to reform both RESPA and TILA. NAR's support for the concept was conditioned on three mandatory provisions:

- Anyone can offer the package, including REALTORS®.
- The package could be offered directly to the consumer. In other words, lenders could not reject a competing package offered by REALTORS® and lenders could not require the use of their package in order for the borrower to get the loan.
- The individual services in the package must be itemized so the consumer can truly comparison shop.

As you know, the HUD 2002 GMP proposal does not include any of these provisions. In fact, one of the key requirements of the HUD GMP is the inclusion of an interest rate guarantee. This clearly limits who can offer packages. While we believe this requirement should be maintained to prevent lenders from employing bait and switch tactics, it does preclude other entities such as real estate brokers from participating in a packaging world. The Section 8 exemption also gives the largest players in the lending industry a distinct competitive advantage. If smaller entities are driven from the market, the consumer will have fewer choices for loan products and settlement services. In addition, a Section 8 exemption is not necessary to offer packaged services. There are a growing number of lenders who are offering guaranteed products today without rule changes.

That is why we have urged HUD to conduct the much needed economic analysis to assess the impact to those industry players who will not be able to package or will not be able to compete with the large national lenders. HUD should also seek input on alternative packaging proposals, such as the two-package model and assess those impacts as well.

In 1997, it may have appeared that RESPA was not keeping pace with the times. However in 2003, one-stop-shopping is available without sacrificing the consumer protections of Section 8. Many borrowers can take advantage of AfBA's that offer this capability, as well as shop among the many lenders who are already offering the guaranteed one-fee programs within the current regulatory guidelines.

As for recent consumer research, our Research Department routinely conducts surveys of homebuyers and sellers to gather information about their most recent experience in the transaction. I am enclosing the NAR 2002 Profile of Homebuyers and Sellers* and will forward to you the 2003 Profile once it is complete.

*Held in Committee files.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED FROM MARGOT SAUNDERS

Summary

Q.1. In your testimony, you mention that the Proposed Rule does not include provisions to sufficiently address the need for better enforcement of RESPA regulations. Please provide this Committee with specific language that HUD could add to the Proposed Rule to assist consumers in enforcing both the Enhanced Good Faith Estimate (GFE) and Guaranteed Mortgage Package (GMP) provisions.

Similarly, please suggest language to the Committee that HUD could add to the Proposed Rule to ensure that the GMP provision does not apply to loans in the subprime market.

A.1. Even perfect consumer protection rules will only work in the marketplace if they are enforced in a meaningful way. Lenders must have incentives to comply with the rules, because lack of compliance is too costly. The Proposed Rule does not currently include *any* mechanisms to punish transgressors. The proposal only provides that once the transgression is caught, the remedy is for the lender to provide what was promised all along. This rewards *lack of compliance* because the cost of being caught breaking the rules is the same as compliance. And this is frankly absurd. HUD must provide a means to make it cost originators if they violate these Proposed Rules—or else the Rules are virtually meaningless. We propose several specific measures to make the new RESPA Rules meaningful:

GMPA

- HUD must remove its stated prohibition against enforcing violations of Section 8 through class actions. The 2001 Statement of Policy explicitly requires a court's individual review of each transaction, eliminating the efficient enforcement mechanism of class actions. Once HUD's Proposed Rules provide the new Rules of the road, there is no reason a court cannot evaluate and enforce the yield spread requirements in class reviews—as the only issue will be whether the mortgage broker actually gave the consumer the full benefit of the payment from the lender.
- A lender's failure to follow the rules for the new Good Faith Estimate must be actionable in some manner, other than merely regulatory enforcement—as regulatory enforcement has shown that it is not sufficient to encourage the industry to comply with the law. Although the RESPA statute does not provide a private right of action in this regard, HUD can and should articulate that it believes the failure to comply with these rules is unfair and deceptive. This should enable some private enforcement under State and Federal prohibitions against unfair and deceptive acts and practices.
- A lender's failure to follow the rules when offering a GMPA or to close on a loan thereafter that does not conform to the GMPA must presumptively violate RESPA's Section 8. The current proposal results in the lender losing its exemption from Section 8 coverage and only allows the consumer a potential contract action against the lender for not keeping the promises in the GMPA. This is completely ineffective. As attorney's fees are gen-

erally not available for breach of contract, few consumers will have the means to bring a case to court for the few thousand dollars which would be obtained in a contract action on most failed GMPA's. Further, consumers will not have the means to allege a *prima facie* case of a violation of Section 8 as the GMPA scenario dictates that neither the initial estimate, nor the HUD–1 will provide details on the payments of fees for services provided by third parties. Therefore, HUD must state that if a lender fails to comply with the promises made in the GMPA, there is a *presumption that the lender has violated Section 8.*

Enhanced Good Faith Estimate

Our recommendations for specific enforcement mechanisms of the Enhanced Good Faith Estimate are closely tied to our more specific recommendations for how to deal with the problems of yield spread premiums. We believe that there must be a separate contract established between the broker and the consumer.

As the Secretary has indicated, the goal is to change the current practices of allowing yield spread premiums to operate simply to increase the profit of mortgage brokers and lenders while providing little or no benefit to consumers. Given the statements of the Secretary, and the extensive testimony at the recent Senate hearings,[1] the lack of correlation between the fees paid to a mortgage broker on a given loan and the amount of work performed by the mortgage brokers on that loan should be an accepted fact at this point. However, for HUD to make the Secretary's promise[2] a reality, several more decisive steps must be taken.

- HUD must *substantively* change the regulations regarding the payments of the yield spread, not just the sections relating to disclosures.
- Before any payment is made to the broker, the borrower and the mortgage broker must enter into a *binding fee agreement*[3] regarding the total compensation, however denominated, to be paid to the broker.
- The borrower must be offered a choice of how to pay the broker fee, whether in cash, by borrowing more, or by increasing the interest rate and having the lender pay the broker fee.[4]
- This choice should be offered after loan approval but before the settlement.
- The amount the broker is paid must be the same whether paid by the borrower or the lender. The amount paid the broker by the lender reduces, by the exact amount, the amount owed by the borrower to the mortgage broker.

---

[1] *See Predatory Mortgage Lending Practices: Abusive Uses of Yield Spread Premiums,* Hearing Before the Senate Banking Committee (January 8, 2002), *http://www.senate.gov/~banking/_files/107–857.pdf.*

[2] Regarding this new Rule, the Secretary said: "The new policy will make clear that it is illegal for a settlement service provider to mark-up fees when it is making a payment to another settlement service provider, unless it provides additional value to the homebuyer in the process, or when a provider does no work for the fee and charges an unreasonable amount." *See* HUD No. 01–105, October 15, 2002, "Martinez Moves to Protect Homebuyers; Calls for Simplified Mortgage Process."

[3] *See* attached Appendix 2, Model Broker Fee Agreement.

[4] *See* attached Appendix 3, Model Choice of Compensation Agreement.

- The total amount paid by the borrower and lender must be reasonable compensation for goods, services, and facilities actually provided.

These principles accomplish several things. First, the consumer knows up-front how much the mortgage broker will charge. Second, the consumer is given the opportunity to choose how this payment will be paid. Third, and most importantly, the broker compensation remains the same regardless of method of payment. This point is crucial, because it eliminates any anticompetitive incentive the broker has to place the borrower in a loan with an interest rate greater than that for which the borrower would otherwise qualify. In other words, whether the borrower chooses a below-par loan, a par loan, or an above-par loan with a yield spread premium, the broker compensation will remain the same. This is not how the system works today and it must be changed.

HUD's current proposal on how to treat yield spread premiums is a variation of these principles. However, as currently configured, they are neither clear enough to offer real protections to consumers, nor are they enforceable by consumers. For example, under the new proposal it is not at all clear how and when the consumer actually exercises the choice of whether to *use* the yield spread premium. The proposed information to be included in the GFE does not necessarily include loan terms which are actually available to the consumer. It is not clear how the consumer should indicate the choice actually made.

We strongly recommend that HUD make good on the Secretary's promises and make the yield spread premium a useable—and enforceable—credit for the consumer. This can best be done by requiring two separate agreements to be executed between the consumer and the broker, one at the beginning of the relationship in which the broker states the total amount of compensation to be received for the loan, and another when the loan has been approved in which the consumer is informed of the various options by which he/she can pay the broker's fee and other closing costs, and the consumer exercises that option.

APPENDIX 1 provides examples of how the regulations in Section 3500.14 should be rewritten to accomplish these principles. APPENDICES 2 AND 3 are samples of both agreements to be required between brokers and consumers.

Guaranteed Mortgage Package

As we have said previously, for the Guaranteed Mortgage Package Agreement to work in the marketplace, the promises made to the consumer must be binding. To be truly binding, the lender's failure to abide by the promises made in the GMPA must trigger sufficient penalties to provide incentives for lenders to comply with the contractual promises. Governmental enforcement of those requirements of RESPA which lack private enforcement has been notoriously weak. Private enforcement is essential. Providing that a lender loses its exemption from Section 8[5] is useless, because the consumer must still prove that an illegal referral has occurred.

[5] 12 U.S.C. § 2607.

Only now, without the disclosures required by the HUD–1,[6] the consumer will have no information on which to base even a *prima facie* case of a violation of the prohibition against referrals.

Instead, consumers who claim that a lender has failed to comply with the promises made in the GMPA, should be able to allege a presumption that Section 8 has been violated. The lender will then have the opportunity to rebut the presumption, but the burden will be on the lender, not the consumer.

The following change in HUD's Proposed Rules would be necessary to accomplish this:

The proposed Regulation X, 24 CFR § 3500.14(e), would need to be amended by adding the following new subsection at the end of the proposed regulation:

> "(4) A consumer who proves by a preponderance of the evidence that a lender has failed to provide a Guaranteed Mortgage Package to a borrower as promised by the Guaranteed Mortgage Package Agreement shall be presumed to have violated the prohibitions of Section 8 of RESPA (12 U.S.C. § 2607)."

Criteria for Excluding Subprime Loans from the GMPA

While it may be difficult to define a subprime loan, we can define the *characteristics* of *predatory* loans. One thing we know is that HOEPA only covers a small percentage of subprime loans.[7] The HOEPA triggers suggested by HUD in the Proposed Rule do not provide nearly enough protection. Currently advocates estimate the bulk of predatory loans finance in the range of 5 to 8 percent of the principle of the loan for points, fees, and closing costs.[8] HUD has already stated that financing more than 3 percent of points and fees is a sign of a predatory loan.[9] Further, in its regulations of the GSE's HUD has prohibited the provision of housing credits for loans in which more than 5 percent of the principal has been charged.[10] It is also important to note that many of the new antipredatory lending laws passed by the States have used a points and fees trigger of 5 percent for coverage.[11]

Thus, to ensure that HUD's new GMPA does *not* facilitate and protect predatory loans from legal scrutiny, any loan that meets

[6] 12 U.S.C. § 2603.

[7] Federal Reserve Board, Final Rule, Statement of Basis and Purpose, 66 Fed. Reg. 65604, 65607 (December 20, 2001).

[8] This information is gleaned from the hundreds of loan documents reviewed each year by the attorneys at the National Consumer Law Center. *See also* Washington Department of Financial Institutions, *Expanded Report of Examination for Household Financial Corporation III as of April 30, 2002,* at 48 (finding that Household charged 7.4 percent in up-front costs on most loans), *available at news.bellinghamherald.com.*

[9] *See* U.S. Department of the Treasury and U.S. Department of Housing and Urban Development, *Curbing Predatory Home Mortgage Lending* (June 20, 2000) at 11. (For press release and the report, *see http://www.hud.gov/library/bookshelf18/pressrel/pr00–142.html.)* The agencies noted the dangers of financing high fees on homeowners:

> Financing points and fees may disguise the true cost of credit to the borrower, especially for high interest rate loans. Restricting the financing of points and fees for HOEPA loans would cause these costs to be reflected in the interest rate, enabling borrowers to better understand the cost of the loan, and to shop for better terms.

[10] *See* 24 CFR § 81.16(b)(12) and 24 CFR § 81.2. These regulations do allow third-party fees paid for closing costs to be excluded from the 5 percent calculation. However, as these fees would not be itemized on the GMPA, excluding some fees would not be possible. It is also far better, at this point of the development of this new product, to exclude too many loans rather than to include too many and limit enforcement of existing law on predatory mortgages as a result.

[11] *See, e.g.,* N.C.G.S. S.L. 1999–332; Ga. Code Section 7–6A–1 *et seq.;* 2001 N.Y. A.B. 11856 (SN) (October 3, 2002).

any one of the following triggers should *not* be permitted to be made as a GMPA:

- Any HOEPA loan.
- Any loan with a prepayment penalty.
- Any loan with a Guaranteed Mortgage Package price (single fee) —which equals or exceeds 5 percent of the principal of the loan.

The reasons for adopting these criteria are spelled out more fully in our comments provided to HUD on the RESPA Rule.[12]

In other words—in addition to HOEPA loans, any loan which has *either* a prepayment penalty, *or* where the price for the GMPA is equal to or more than the 5 percent of the loan principal, must not be eligible for the exemption outlined in the Proposed Rule. Any lender making a loan with either of these criteria would still be required to itemize the fees paid to settlement service providers pursuant to the rules for the Good Faith Estimate.

Using 5 percent of the principal as the trigger for exclusion from GMPA eligibility will actually result in including loans with a very high up-front cost. And according to various studies, closing costs on conventional mortgages rarely exceed 2 percent of the loan amount.[13] Using 5 percent as the trigger allows ample—perhaps too much—room to ensure that all prime loans for which a GMPA might be appropriate would be eligible for the competitive benefits of the GMPA. However, this figure also ensures that loans which are not truly competitive are excluded from the exemption.[14]

APPENDIX 4 includes our specific proposal for new language in the proposed regulation to accomplish these goals.

---

[12] *See Comments on RESPA Proposed Rule to Simplify and Improve the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers* (to U.S. Department of Housing and Urban Development), filed on behalf of low-income clients of 14 legal services programs, at II(A)(1)(d) and (e). Available at *http:www.consumerlaw.org/initiatives/test__and__comm/content/final__RESPA.pdf.*

[13] *See, e.g.,* Federal Housing Finance Board, *Monthly Interest Rate Survey,* (Table 1: Terms on Conventional Single-Family Mortgages, Annual National Averages, All Homes), *available at www.fhfb.gov/MIRS/mirs__t1.xls, initial fees and charges average less than one point from 1995 through 2000 on conventional residential mortgages.*

[14] For example, a loan of $150,000 would be permitted to have a GMPA package cost of $7,499. A $200,000 loan could have a GMPA price of $9,999. These up-front costs are actually much higher than most competitive, prime loans would ever charge for up-front closing costs. To the extent that the figure of 5 percent may represent too small a sum to compensate lenders for their up-front costs when making small loans (for example, loans of less than $75,000), the 5 percent trigger could be adjusted upwards. However, just as this figure is adjusted upwards for smaller loans, the 5 percent trigger should also be adjusted lower for loans of larger amounts.

Appendix 1

Proposed Changes to RESPA Regulations Relating to Lender Paid Broker Fees:

Add following definitions to § 3500.2(b)

Total compensation received by a mortgage broker for bringing together a borrower and a lender to obtain a federally related mortgage loan for the borrower includes all payments made by the borrower directly to the mortgage broker in cash or in the form of any thing of value, all payments received from the proceeds of the loan, and all payments received from the lender or any other settlement service provider that are directly related to the brokering of the loan.

Par rate means the interest rate offered to a mortgage broker (through lender's price sheets) at which the lender will fund 100% of the loan with no premiums or discounts to the mortgage broker.[15]

Add the following addition to § 3500.14(g).
§ 3500.14(g)(4): The payment of a fee by a lender to a mortgage broker related to the making of a federally related mortgage loan shall not violate Section 8 of RESPA (12 U.S.C. § 2607) or § 3500.14 if all of the conditions set forth in this subsection are satisfied.[16]

(i) The mortgage broker agrees to represent the borrower, to act as the borrower's agent, and to get the most favorable mortgage loan that meets the borrower's stated objectives.[17]

(ii) Prior to the preparation of the mortgage loan application or payment of any fee **by the borrower for any services related to the application or the loan**, whichever is first, the mortgage broker and the borrower **shall** complete and execute a Mortgage Broker Contract, in substantial conformity with the form in Appendix 2 to this part, that states clearly and conspicuously:[18]

(A) the mortgage broker's total compensation, expressed both as a dollar amount and

[15] Source: HUD Statement of Policy 1999-1, 64 Fed. Reg. 10080, 10081 n.1 (Mar. 1, 1999).

[16] Source: Language mirrors affiliated business arrangement exemption in 24 C.F.R. § 3500.15(b).

[17] Source: HUD Proposed Rule, 62 Fed. Reg. 53912, 53927 (Oct 16, 1997) (proposed Mortgage Broker Contract, Appendix 2). *See also*, Federal Reserve/HUD Joint Statement to Congress on RESPA/TILA reform (1998).

[18] Source: HUD Proposed Rule, 62 Fed. Reg. 53912, 53927 (Oct 16, 1997) (proposed Mortgage Broker Contract, Appendix 2). *See also*, Federal Reserve/HUD Joint Statement to Congress on RESPA/TILA reform (1998).

as a percent of the loan amount requested by the borrower;

(B) the borrower owes any compensation to the mortgage broker only if the borrower enters into a federally related mortgage loan with a lender to whom the mortgage broker referred the borrower; and

(C) the available methods by which the borrower can choose to pay the mortgage broker the total compensation in the Mortgage Broker Contract.

(iii) Following loan approval, but no later than five (5) business days before settlement, the lender and borrower enter into a Broker Funding Contract, in substantial conformity with the form in Appendix 3 to this part, that states clearly and conspicuously:

(A) the available methods by which the borrower can pay the mortgage broker the total compensation disclosed in the Mortgage Broker Contract;

(B) the par rate, the proposed interest rate, and the monthly payment (excluding escrow) of any method described in § 3500.14(g)(4)(ii)(A) when the lender offers to pay all or part of the total compensation to the mortgage broker through funds resulting from an interest rate higher than the par rate for a mortgage loan with otherwise equivalent terms and fees;

(C) that the borrower may select one of the methods described in § 3500.14(g)(4)(ii)(A).

(iv) The total compensation paid to the mortgage broker compensates the broker for goods, services, and facilities and is reasonably related to the value of such good, services, and facilities.

(v) Any fee paid by the lender to the mortgage broker for the federally related mortgage loan reduces, dollar for dollar, the amount owed to the mortgage broker by the borrower pursuant to the Mortgage Broker Contract described in § 3500.14(g)(4)(ii) and must be paid at or before the settlement.

(vi) The borrower receives a copy of the Mortgage Broker Contract described in § 3500.14(g)(4)(ii), and the Broker Funding Contract described in § 3500.14(g)(4)(iii) on the date each is signed by the borrower.

(vii) The mortgage loan, the Mortgage Broker Contract, and Broker Funding Contract do not contain provisions that waive or restrict the borrower's right to enforce the provisions of RESPA and these regulations or other rights related to the mortgage through judicial process.

3. **Add Supplementary Information regarding applicable date.** These amendments apply to mortgage loans entered into on or after January 1, 2003 [or other date in the future].

4. **Add Appendix 2, Model Mortgage Broker Agreement**

5. **Add Appendix 3, Mortgage Broker Method of Compensation Agreement**

Appendix 2
Model Mortgage Broker Agreement

Mortgage Broker Fee. You are duly authorized to assist me in obtaining a home mortgage loan. If you successfully assist me in obtaining a home mortgage loan, your total compensation from any and all sources will be:

$____________

This amount equals ______________% of the total I wish to borrow of ________.

Method of Broker Fee Payment. I understand that after I am approved for a loan, I will be given a choice as to how I will pay your total compensation.

1. ***If I want to receive the lowest interest rate for which I qualify,*** I will pay you in full directly either in cash or from the proceeds of the loan.

2. ***If I want to minimize the amount that I directly pay you,*** I will authorize the lender to pay all or some of your total compensation on my behalf. If I choose to have the lender make this payment, I understand that, in order to repay the lender, my interest rate will be higher than the interest rate for which I would otherwise qualify.

Mortgage Broker Responsibilities:

You will represent my interests. You will act as my agent. You will attempt to get me the most favorable mortgage loan that meets my objectives.

Termination. This agreement will continue until one of the following events occurs:

- I fail to receive loan approval;
- My loan closes;
- I terminate your services;
- ___________ days expire from the date of this agreement without any of the foregoing occurring.

Signing this contract does not obligate me to obtain a mortgage loan through this mortgage broker, nor does it constitute mortgage loan approval.

* * Applicant_____________________ Date_________________

* * Applicant_____________________ Date_________________

_______________________________ Date_________________
Mortgage Broker Signature
Mortgage Broker License No. (where applicable) ______________________

Appendix 3
Mortgage Broker Method of Compensation Agreement

You have previously agreed to pay your mortgage broker $_____ for assisting you in arranging a loan with our mortgage company.

We have now approved you for a loan in the amount of $________ at an interest rate of ________.

If you are interested in accepting this loan, you can now lock in your interest rate and choose the method by which your mortgage broker will be paid.

You have the following three choices:

1. I choose to pay the mortgage broker $______ on the day of settlement from my own funds and/or from the loan proceeds.

I will directly pay the broker $ ____, and obtain a loan with an interest rate of ___%.

2. I choose to have the mortgage lender pay the mortgage broker its entire fee of $______. **I understand that by having the mortgage lender pay the entire broker fee, my interest rate will be higher than the interest rate for which I would otherwise qualify**.

I will directly pay the broker $ 0, and obtain a loan with an interest rate of ___%.

3. I choose to pay the mortgage broker $______ on the day of settlement from my own funds and/or from the loan proceeds and have the lender pay the remainder of the fee in the amount of $_____. **I understand that by having the mortgage lender pay a portion of the broker fee, my interest rate will be higher than the interest rate for which I would otherwise qualify for.**

I will directly pay the mortgage broker $_____, and obtain a loan with an interest rate of ___%.

Your signature on this document does not obligate you to complete this loan

______________________	______________________
Borrower's Signature	Date

Appendix 4

Proposed changes to § 3500.16 Guaranteed Mortgage Package – Safe Harbor

(New language is in **bold.**)

. . . .

(e) *Exclusions from safe harbor.*

. . .

(3) The Guaranteed Mortgage Package safe harbor shall not be available where **any of the following occur:**

> **(A)** the rate or fees of a Federally related mortgage loan make the loan subject to the Home Ownership Equity Protection Act (HOEPA);
>
> **(B) a federally related mortgage loan includes any penalty for prepayment of all or part of the principal of the loan;**
>
> **(C) the price for the Guaranteed Mortgage Package for the services referred to in subsection (c) do not equal or exceed 5% of the principal amount of a federally related mortgage loan.**

RESPONSE TO WRITTEN QUESTIONS OF SENATOR REED FROM JOHN A. COURSON

Q.1. Do you agree that Hispanic small businesses will be hurt by the Proposed Rule? Why or why not?

A.1. MBA disagrees with this forecast. For various reasons, MBA believes that small businesses will not be disadvantaged under this Rule. As a first observation, we note that small brokers and originators compete very effectively today, and capture a significant portion of the origination market, even though they are out-sized and out-capitalized by large multistate lenders. In effect, the nature of today's national mortgage market allows small originators access to many sources of capital, which empowers them to successfully compete on price and service. There is no reason to expect that this will change under a GMP system.

Second, Mr. Acosta's grim predictions are premised on an assumption that the mortgage market is static and will not adapt to HUD's proconsumer proposals. MBA disagrees, and posits that there will be tremendous market movements to create national sources for settlement services that will allow small businesses to thrive and fully compete in the marketplace. In effect, we expect, and are already seeing movements toward, the formation of third-party "packagers" and "co-op" arrangements that will give rise to business alliances and opportunities for small businesses that are not possible today.

On this point, we also note that our Association can speak with credibility, as the MBA's membership is largely composed of smaller businesses, with more than 50 percent of our members being small or moderate-sized players in the lending industry. Today, our smallest members are successful in competing against the large providers, and that will not change under HUD's new regulatory system.

Q.2. Do you agree that Hispanic and other minority homebuyers will be hurt by the Proposed Rule? Why or why not?

A.2. MBA disagrees with the statement that minority homebuyers will be hurt by the Proposed Rule. In fact, a central reason MBA is in full support of the concept of packaging is that we believe that it will provide a system of consumer protection that is superior to the confusing and unenforceable scheme that is in place today. Unlike the current system, the GMP rules would allow consumers to shop the market with the confidence that they are comparing actual, final, and enforceable cost figures. Since the Guaranteed Mortgage Package price incorporates practically all costs required to close the loan, the consumer's comparison shopping will not be clouded or confused by meaningless numbers.

In addition, the "Guaranteed Mortgage Package Agreement" empowers a consumer to easily detect inaccurate disclosures and effectively enforce his or her rights and benefits in the bargain. Unlike the current system that allows for variances between the Good Faith Estimate and the HUD–1, HUD's proposed GMP system imposes a "zero" tolerance on the initial and final disclosures; a mere inspection and comparison between the initial disclosure and the closing statement will suffice to clearly expose whether the costs

were improperly inflated. The streamlining also eases enforcement for Government regulators, and will make it much tougher to defraud the public.

We note that MBA's assertions that "packaging" offers very real consumer benefits is, in part, confirmed by the statements of consumer advocates, including the National Consumer Law Center and the National Association of Consumer Advocates, in testimony before the Committee. In effect, these groups expressed a view that "packaging" will offer consumers a simpler and more effective shopping system.

RESPONSE TO WRITTEN QUESTION OF SENATOR REED FROM NEILL FENDLY

Q.1. Mortgage brokers are often compared to mortgage lenders in the homebuying process since they are both selling mortgages. While they are both selling mortgages, consumers understand that lenders are selling their own product and price accordingly. Unlike lenders, brokers are selling mortgages from other companies, just as realtors are selling houses from other realtors or owners. We all know how much realtors charge for their service, 3 percent of the value of the home from the seller's agent and 3 percent from the buyer's agent. Brokers are essentially providing a service to borrowers, and therefore their pricing should reflect that fact. Why shouldn't consumers have a right to know how much their brokers receive for their services, just as they know how much their realtors charge?

A.1. Currently, mortgage brokers disclose their compensation on the Good Faith Estimate and on the HUD–1 Settlement Statement as required under the Real Estate Settlement Procedures Act (RESPA) implementing regulation, Regulation X.[1] NAMB is *not* proposing that this requirement be eliminated. However, NAMB does have serious concerns with HUD's characterization of a mortgage broker's compensation as explained in HUD's Proposed Rule,[2] since it provides less clarity to consumers than as presently disclosed, is inconsistent with HUD's Statements of Policy 1999–1 and 2001–1, and places the mortgage broker at a serious disadvantage because it requires that mortgage brokers include their compensation in the calculation of Net Loan Origination Charge, but does not require the same of all originators. NAMB has spent countless hours and resources to strengthen, simplify, and clarify the disclosure of costs provided to consumers in advance of settlement. In fact, NAMB has submitted an alternative disclosure form set forth in its comment letter that satisfies HUD's objectives[3] to simplify and clarify the disclosure of settlement costs, but not at the expense of small business or to the detriment of consumers. In this disclosure, a mortgage broker will disclose the maximum amount of compensation that it will receive, in a dollar amount, for the

[1] 24 CFR part 3500, Appendix B.
[2] "Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process for Obtaining Mortgages to Reduce Settlement Costs to Consumers," U.S. Department of Housing and Urban Development, Docket Number: FR–4727–P–01, July 29, 2002.
[3] HUD states in the Proposed Rule that one of its objectives is that "settlement cost disclosures need to be improved so that the information they provide is simpler, clearer, more reliable, and reasonably available to facilitate shopping, increase competition, and lower settlement costs." Real Estate Settlement Procedures Act, 67 Fed. Reg., 49,134, 49,135 (July 29, 2002).

goods, facilities, and services it furnishes or provides to the lender and the borrower in connection with the mortgage loan. NAMB believes that its disclosure form levels the playing field between originators, as well as provides more clarity to consumers on the fees that the borrower will have to pay in connection with a mortgage loan, including broker compensation.

STATEMENT OF AMERICA'S COMMUNITY BANKERS

APRIL 8, 2003

America's Community Bankers represents the Nation's community banks of all charter types and sizes. ACB's member banks originate more than 25 percent of all mortgages in the United States, and significantly more than half of all mortgages originated by depository institutions. In addition, ACB members operate a large number of mortgage banking affiliates that originate a substantial part of the business from that segment of the industry.

ACB believes that small- to medium-sized lenders are an integral part of the mortgage process and that it is imperative that they be able to be a part of the packaging option to the extent they wish. ACB believes that many community banks will be able to work with third parties in their local communities to offer an attractive package.

However, it may be that the optimal way for smaller institutions to participate in the packaging option may be for a third party to coordinate, subcontract, or otherwise negotiate and arrange the Guaranteed Mortgage Package. ACB believes that the exemption from Section 8 liability should extend to the activities currently permitted pursuant to HUD's policy.

Summary of HUD's Proposed RESPA Rule

On the three areas of the proposal, ACB generally supports the concept of the Guaranteed Mortgage Package and the concept of requiring mortgage broker disclosures. However, ACB strongly urges HUD to reconsider making changes to the Good Faith Estimate contemporaneously with introduction of the Guaranteed Mortgage Package. ACB believes that making all of these changes at the same time would unnecessarily disrupt the mortgage market.

Mortgage Broker Disclosures

ACB believes that the addition of mortgage broker fee disclosures is an important element of mortgage reform. ACB supports HUD in its efforts to require this disclosure and ACB does not believe that potential delays in other elements of the proposal should result in a delay in requiring this disclosure. Fees charged by mortgage brokers are frequently misunderstood by consumers. ACB urges HUD to include an easy to understand mortgage broker disclosure requirement in any Final Rule that is issued.

The Guaranteed Mortgage Package and the Good Faith Estimate of the Proposal Must Be Separated

ACB supports the option of the Guaranteed Mortgage Package but strongly believes that the current Good Faith Estimate must remain an alternative for those lenders who do not wish to package or are unable to do so. As important as it is that consumers be able to comparison shop for mortgage credit, lenders must be able to offer an array of products to meet varying needs of the customer and to give consumers disclosures that are meaningful.

If the Guaranteed Mortgage Package succeeds, it will be because the market is ready for such an alternative and it is found to be a meaningful shopping tool by consumers. The experiment also will succeed if lenders and other companies are able to put together packages in an efficient and cost-effective manner. However, given the vast array of mortgage products, even those lenders who package may not be able to provide all of the options that consumers need. Each of these concerns may limit the viability of the Guaranteed Mortgage Package. The only fair way to determine if it will work is to try the alternative, while allowing lenders who do not wish to package to use the current mortgage origination process.

The proposed Guaranteed Mortgage Package arguably would provide consumers an easy method of comparison-shopping. However, we are concerned that providing a "so-called" interest rate guarantee that is held open for a minimum of 30 days, as part of the package would not work. It should be clarified that the guarantee only applies to the relationship between the lending rate and an index rate, and the length of commitment should be shortened to industry norms. ACB suggests that HUD work with lenders to develop a methodology for establishing and adjusting rates.

ACB strongly believes that implementing the Guaranteed Mortgage Package, while attempting to significantly change Good Faith Estimate procedures at the same time, would create undo stress on the mortgage markets.

Conclusion

The ACB strongly supports mortgage reform. ACB urges HUD to implement in a timely manner mortgage broker fee disclosures, and separate the implementation of the Guaranteed Mortgage Package from the revised Good Faith Estimate. Mortgage broker fee disclosures are an integral part of making mortgage fees comprehensible to consumers. The Guaranteed Mortgage Package, with revisions, should take priority and be tested in the market as soon as practicable. Revisions to the Good Faith Estimate should be postponed, reexamined, and adjusted as the Guaranteed Mortgage Package is being tested.

ACB members stand ready to work with Members of the Senate Banking Committee and HUD to complete the RESPA reform process in a way that is efficient and feasible.

STATEMENT OF THE SENIORS COALITION

APRIL 8, 2003

The Seniors Coalition respectfully submits the following statement for the written record of the Committee's hearing on the Department of Housing and Urban Development's (HUD) proposal to reform its regulations implementing the Real Estate Settlement Procedures Act (RESPA).

The Seniors Coalition is a nonprofit, nonpartisan, education, and issue advocacy organization that represents the interests and concerns of America's senior citizens at both the State and Federal levels. Our mission is to protect the quality of life and economic well-being that older Americans have earned while supporting the common-sense solutions to the challenges of the future. With nearly four million members and supporters nationwide, the Seniors Coalition is the Nation's largest market-oriented senior advocacy group.

The Seniors Coalition believes that HUD's proposal represents a major step toward meeting the promise of RESPA—simplifying and improving the process by which consumers obtain mortgage loans in this country. Seniors are active participants in the mortgage market, and we, like other consumers, would benefit from a more efficient and transparent marketplace for settlement costs.

In its nearly 30-year history, RESPA has not delivered on its promise. Instead, consumers continue to be confused about the cost of settlement services and to suffer unwelcome surprises at the closing table. Moreover, the existing RESPA Rules effectively *prohibit* pro-consumer practices that would lower consumer costs and simplify the mortgage loan process. In addition, the complexity and ambiguity of the existing rules have spawned a cottage industry of class action litigation against "deep-pocket" mortgage lenders, discouraging them from adopting innovations that would lower costs and simplify the process for consumers.

For those reasons, we strongly support the central feature of HUD's proposal—the opportunity for loan originators and other settlement service providers to offer guaranteed closing cost packages (Guaranteed Mortgage Packages or GMP's) to consumers. With the GMP, key information will be made available to consumers in a comprehensible form, early in the loan shopping process so that the consumer can use it to comparison shop.

The GMP offers a market-based solution to the problem of perceived overcharges and "bait and switch" tactics that have plagued certain segments of the mortgage industry. We are particularly concerned about these practices because they are often targeted at senior citizens. HUD comes at this problem with a fresh, new approach. Rather than maintaining strict regulatory restrictions on the way in which settlement services are priced and provided, the proposal opens up this process to negotiation and competition. As HUD stated in its economic analysis accompanying the proposal, "[c]ompetition is substituted for regulation."

We believe that the GMP experiment will work, where traditional approaches have failed, for two reasons.

First, the GMP gives consumers real, guaranteed information that they can use when they shop for a loan. This is in contrast to the current system, which provides unreliable estimates for a laundry list of charges that, experience has shown, are not useful for shopping. The current system is based on the unrealistic notion that consumers understand and are in a position to shop for the various components of closing costs. Conversely, the GMP would give them a single, understandable, and legally enforceable figure, at the beginning of the process, that they could use to compare the charges of various providers.

Second, the GMP gives lenders an incentive to reduce the cost of ancillary services. The GMP would allow packagers to use their purchasing leverage to lower these costs—a practice that RESPA, to date, has effectively prohibited.

Thus, we applaud HUD for proposing the GMP as an option that allows lenders or other packagers to reduce consumer costs. It should be noted that the GMP will remain optional, and consumers will retain the alternative of receiving a Good Faith Estimate (GFE) under current law. The Seniors Coalition believes, however, that consumers will quickly prefer the simplicity and lower costs of an appropriately structured GMP.

Although the concept of the proposal is sound, there are several technical changes that are needed to make lower, understandable closing costs for consumers a reality:

- **HUD should not require an interest rate guarantee as part of the GMP.** The interest rate cannot be a "guaranteed rate" until the consumer locks in the rate and qualifies for the loan. It is unrealistic for a lender to do all the underwriting necessary within 3 days after application to give a definite approval or disapproval on the loan, so any interest rate and discount points combination will be conditional on final underwriting. Moreover, a consumer who wants to shop for closing costs should not have to give up the flexibility and lower cost of "floating" the rate until he or she decides that it is time to lock-in a rate. Long-term rate lock-ins are expensive because the lender must hedge against the possibility of an increase in the rate, and those costs are passed on to consumers. If HUD is concerned that lenders or other packagers will trade lower closing costs for higher rates and points, there are mechanisms—such as requiring lenders to post their prices on a daily basis—that would address those concerns without forcing consumers to choose between saving on their settlement charges and paying for a rate lock-in they don't want.
- **Discount points should not be included in the guaranteed cost amount.** Discount points are part of the loan price, like the interest rate. To give consumers the flexibility to choose among various rate/point options, it is important that points be disclosed separately with the interest rate, rather than included with other fixed, closing costs in the guaranteed cost amount.
- **The GMPA should be simplified.** The beauty of the GMP concept is that it provides more certain information to the consumer with which he or she can comparison shop. It is critical, however, that the information in the Guaranteed Mortgage Package Agreement be provided in a simple and readable manner. A multi-page document filled with detailed information and charts that requires a lot of time to understand and digest is not likely to be used by a majority of consumers. In addition, much of the information in the proposed GMPA is duplicative of information provided in the Truth in Lending Act (TILA) disclosures. There should be a way to combine these disclosures so that the confusion of duplication is avoided particularly if an item, such as the APR, that is disclosed in the GMPA differs from the same item disclosed on the TILA, which may readily occur, depending upon the timing of the delivery of these two disclosures.
- **Subprime customers should get the benefits of the GMP.** The proposal does not allow customers whose loans are subject to the Home Ownership and Equity Protection Act (HOEPA) to benefit from the simplicity and lower costs of the GMP. The Seniors Coalition strongly disagrees with this position. Many alleged incidents of predatory lending involve inflation of the "hidden costs" of the loan. The GMP would clearly disclose the total closing costs, allowing HOEPA borrowers to focus on obtaining the best loan rate, discount points, and closing costs for the loan. While the RESPA proposal is not a cure-all for predatory lending, we think that by arming consumers with a better understanding of the total costs of a loan, it will significantly help consumers avoid abusive loan origination practices.
- **The benefits of HUD's proposal should not be frustrated by conflicting State law limitations.** There are many State laws that conflict with the simplified approach of HUD's GMP proposal, including laws that require itemization of fees or limits on fees. At the Federal level, HUD is replacing this type of regulation with competition, and letting market forces work to the benefit of consumers. HUD should clarify—and if necessary Congress should confirm by legislation—that a lender or other packager may offer the GMP option without regard to State laws that prohibit the same types of pro-consumer efficiencies that would be prevented under the current Federal rules.
- **HUD should delay the effective date of the changes to the GFE.** Although we support the concept of improving the comprehensibility of the GFE, as a practical matter, requiring significant changes to the GFE while at the same time

introducing the GMP will not yield benefits for consumers. Many lenders and other potential packagers will defer implementing the optional GMP until they have completed the expensive changes to the GFE, which would be mandatory in transactions not involving a GMP. Therefore, we recommend that HUD put the GMP in place first, to give it a chance to work in the marketplace, and then go back and examine whether changes need to be made to the GFE.

The Seniors Coalition thanks the Committee for the opportunity to present its views on HUD's innovative and pro-consumer proposal.